

**NEW ISSUE – BOOK-ENTRY ONLY**

**Insured Ratings:**

**Moody's: Aaa**

**S&P: AAA**

**Fitch: AAA**

**Uninsured Ratings:**

**Moody's: A1**

**S&P: A+**

**Fitch: A+**

**(see "Ratings" herein)**

*In the opinion of Co-Bond Counsel to the State, interest on the Bonds is excluded from gross income for federal income tax purposes and exempt from State of California personal income taxes, all as further discussed in "TAX MATTERS" herein.*

**\$800,000,000**  
**STATE OF CALIFORNIA**  
**VARIOUS PURPOSE GENERAL OBLIGATION BONDS**

**Dated:** September 1, 2006

**Due:** September 1, as shown on the inside cover

Interest on the Bonds is payable on March 1 and September 1 of each year, commencing on March 1, 2007. The Bonds of each maturity will bear interest from their dated date to their maturity or prior redemption at the respective rates set forth on the inside cover page hereof. Bonds may be purchased in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. See "THE BONDS-General" and APPENDIX B-"DTC AND THE BOOK-ENTRY SYSTEM."

Certain of the Bonds are subject to redemption prior to their stated maturities, as described herein. See "THE BONDS-Redemption Provisions."

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS."

This cover page contains certain information for general reference only. It is not a summary of the security or terms of this issue. Investors are advised to read the entire Official Statement to obtain information essential to the making of an informed investment decision.

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES,  
YIELDS, AND CUSIPS**  
**(See Inside Front Cover)**

*The Bonds are offered when, as and if issued and received by the initial purchaser, subject to the approval of validity by the Honorable Bill Lockyer, Attorney General of the State of California, by Orrick, Herrington & Sutcliffe LLP and by Lofton & Jennings, Co-Bond Counsel to the State. Orrick, Herrington & Sutcliffe LLP served as Disclosure Counsel to the State. Public Resources Advisory Group served as the Financial Advisor to the State. The Bonds are expected to be available for delivery through the facilities of The Depository Trust Company on or about September 14, 2006.*

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**HONORABLE PHILIP ANGELIDES**  
***Treasurer of the State of California***

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**THE BONDS WERE SOLD AT COMPETITIVE BID ON SEPTEMBER 7, 2006**  
**INITIAL REOFFERING YIELDS HAVE BEEN SET BY THE INITIAL PURCHASER**

# MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, YIELDS, AND CUSIPS

**\$800,000,000**

## STATE OF CALIFORNIA VARIOUS PURPOSE GENERAL OBLIGATION BONDS

**Base CUSIP<sup>†</sup>: 13062T**

Maturity Date (September 1)	Principal Amount	Interest Rate	Yield	CUSIP <sup>†</sup>	Maturity Date (September 1)	Principal Amount	Interest Rate	Yield	CUSIP <sup>†</sup>
2007	\$12,000,000	4.50%	3.42%	NR1	2021c	\$22,600,000	5.00%	4.26%	PF5
2008	9,500,000	5.00	3.56	NS9	2022 <sup>(2)</sup>	12,100,000	4.25	4.38	PG3
2009	13,800,000	5.00	3.58	NT7	2023c	12,300,000	5.00	4.31	PH1
2010	19,300,000	5.25	3.67	NU4	2024c	13,500,000	5.00	4.34	PJ7
2011	25,600,000	5.00	3.66	NV2	2025c	17,100,000	5.00	4.36	PK4
2012	33,000,000	5.00	3.72	NW0	2026 <sup>(2)</sup>	16,800,000	4.25	4.44	PL2
2013 <sup>(1)</sup>	35,600,000	4.00	3.68	NX8	2027c	23,500,000	5.00	4.38	PM0
2014 <sup>(1)</sup>	31,600,000	4.00	3.75	NY6	2028c	20,700,000	5.00	4.40	PN8
2015 <sup>(1)</sup>	32,500,000	4.00	3.80	NZ3	2029c	20,200,000	5.00	4.45	PP3
2016 <sup>(1)</sup>	30,800,000	5.00	3.88	PA6	2030c	21,900,000	4.75	4.60	PQ1
2017c	30,900,000	5.00	4.03	PB4	2031c	29,100,000	5.00	4.46	PR9
2018c	34,300,000	5.00	4.14	PC2	2032c	30,300,000	5.00	4.47	PS7
2019c	35,100,000	5.00	4.18	PD0	2033 <sup>(3)</sup>	37,800,000	4.50	4.59	PT5
2020c	28,200,000	5.00	4.18	PE8					

\$149,900,000 4.50% Term Bonds due September 1, 2036, Yield 4.65%, CUSIP<sup>†</sup>: PU2

(Plus accrued interest from September 1, 2006)

<sup>†</sup> Copyright 2006, American Bankers Association. CUSIP data herein is provided by Standard & Poor's CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. CUSIP numbers are provided for convenience of reference only. The State Treasurer assumes no responsibility for the accuracy of such numbers.

c Priced to call at 100% on September 1, 2016.

- (1) At the request of the initial purchaser, payment of the principal of and interest on the Bonds maturing on September 1 of the years 2013 through 2016, when due will be insured by a financial guaranty insurance policy to be issued by MBIA Insurance Corporation simultaneously with the delivery of the Bonds. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS—Bond Insurance for Bonds Maturing on September 1, 2013 through September 1, 2016 Only."
- (2) At the request of the initial purchaser, payment of the principal of and interest on the Bonds maturing on September 1, 2022 and September 1, 2026, when due will be insured by a municipal bond insurance policy to be issued by Financial Security Assurance Inc. simultaneously with the delivery of the Bonds. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS—Bond Insurance for Bonds Maturing on September 1, 2022 and September 1, 2026 Only."
- (3) At the request of the initial purchaser, payment of the principal of and interest on the Bonds maturing on September 1, 2033, when due will be insured by a financial guaranty insurance policy to be issued by Ambac Assurance Corporation simultaneously with the delivery of the Bonds. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS—Bond Insurance for Bonds Maturing on September 1, 2033 Only."

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Copies of this Official Statement may be obtained from:

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1-800-900-3873

**OFFICIAL STATEMENT**  
**\$800,000,000**  
**STATE OF CALIFORNIA**  
**VARIOUS PURPOSE GENERAL OBLIGATION BONDS**

**INTRODUCTION**

*This Introduction contains only a brief summary of the terms of the captioned Bonds and a brief description of this Official Statement; a full review should be made of the entire Official Statement, including the Appendices and the financial statements incorporated by reference. Summaries of provisions of the Constitution and laws of the State of California or any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.*

**Description of the Bonds**

This Official Statement presents certain information relating to the State of California (the “State”) in connection with the sale of general obligation bonds consisting of \$800,000,000 aggregate principal amount of State various purpose general obligation bonds comprised of seventeen series of bonds (the “Bonds”). The Bonds are described further below under “THE BONDS—Identification and Authorization of the Bonds.”

The Bonds will be registered in the name of a nominee of The Depository Trust Company, New York, New York (“DTC”), which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only, in denominations of \$5,000 or any integral multiple thereof. See “THE BONDS—General” and APPENDIX B—“DTC AND THE BOOK-ENTRY SYSTEM.”

The Bonds are authorized by Bond Acts (defined in “AUTHORIZATION OF AND SECURITY FOR THE BONDS—Authorization”) approved by the voters of the State and by resolutions of applicable finance committees (the “Resolutions”) created or designated under the Bond Acts. The Bonds are being issued to current refund outstanding State general obligation commercial paper notes, repay interim loans from the State’s Pooled Money Investment Account that financed construction of various projects under the respective Bond Acts, finance various projects under the respective Bond Acts and pay certain costs of issuance of the Bonds. See “THE BONDS—Purposes of the Bonds.”

**Security and Source of Payment for the Bonds**

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. See “AUTHORIZATION OF AND SECURITY FOR THE BONDS—Security.” Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from moneys in the General Fund of the State Treasury (the “General Fund”), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A—“THE STATE OF CALIFORNIA—STATE FINANCES—The General Fund” and “STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing—General Obligation Bonds.” The Bond Acts authorizing the Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Bonds.

## **Redemption**

The Bonds maturing on and after September 1, 2017 are subject to optional redemption prior to their respective stated maturity dates, in whole or in part as set forth herein. The Term Bonds maturing on September 1, 2036 are subject to mandatory redemption prior to their stated maturity date, in part, from sinking fund payments made by the State. See “THE BONDS–Redemption Provisions.”

## **Information Related to this Official Statement**

The information set forth herein has been obtained from official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale made hereunder or any future use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

All financial and other information presented or incorporated by reference in this Official Statement has been provided by the State from its records, except for information expressly attributed to other sources. The presentation of certain information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. However, certain statements included or incorporated by reference in this Official Statement do constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Any statements made in this Official Statement involving matters of opinion, whether expressly stated or not, are set forth as such and not as representations of fact.

A wide variety of other information, including financial information, concerning the State is available from State agencies, State agency publications and State agency websites. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as expressly noted in APPENDIX A–“THE STATE OF CALIFORNIA–FINANCIAL STATEMENTS.”

The information in APPENDIX B–“DTC AND THE BOOK–ENTRY SYSTEM” has been furnished by DTC and no representation is made by the State or the Financial Advisor as to the accuracy or completeness of such information.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State. This Official Statement is not to be construed as a contract with the purchasers of the Bonds.

This Official Statement does not constitute an offer to sell the Bonds or the solicitation of an offer to buy, nor shall there be any sale of, the Bonds by any person in any state or other jurisdiction to any person to whom it is unlawful to make such offer, solicitation or sale in such state or jurisdiction.

## **Plan of Distribution**

The Bonds were sold pursuant to competitive bid on September 7, 2006.

## **Continuing Disclosure**

The State Treasurer will agree on behalf of the State to provide annually certain financial information and operating data relating to the State by not later than April 1 of each year in which any Bonds are outstanding (the “Annual Report”), commencing with the report containing 2005–2006 Fiscal Year financial information, and to provide notice of the occurrence of certain enumerated events if material. The specific nature of the information to be contained in the Annual Report and the notices of material events and certain other terms of the continuing disclosure obligation are set forth in APPENDIX C–“FORM OF CONTINUING DISCLOSURE CERTIFICATE.”

The State has not failed to comply, in all material respects, with any “previous undertakings,” as that term is used in Rule 15c2–12 (the “Rule”) promulgated under the Securities and Exchange Act of 1934, as amended.

## **AUTHORIZATION OF AND SECURITY FOR THE BONDS**

### **Authorization**

Each general obligation bond act authorizing the issuance of the Bonds (collectively, the “Bond Acts”) incorporates by reference the State General Obligation Bond Law (the “Law”) in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code. The Law provides for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds.

### **Security**

The Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The Bond Acts provide that the State will collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient, in addition to the ordinary revenue of the State, to pay principal of and interest on the Bonds. The Bond Acts also contain a continuing appropriation from the General Fund of the sum annually necessary to pay the principal of and interest on the Bonds as they become due and payable. It is an event of default of the State to fail to pay or to fail to cause to be paid the principal of or interest on the Bonds when due or to declare a moratorium on the payment of, or to repudiate any Bond.

The full faith and credit of the State are pledged for the punctual payment of the principal of and the interest on the Bonds. All payments of principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, have an equal claim to the General Fund, subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A–“THE STATE OF CALIFORNIA–STATE INDEBTEDNESS AND OTHER OBLIGATIONS–Capital Facilities Financing–General Obligation Bonds.”

### **Remedies**

It is an event of default of the State under the Resolutions authorizing the Bonds pursuant to the respective Bond Acts to fail to pay or to fail to cause to be paid, when due, or to declare a moratorium on the payment of, or to repudiate any Bond.

In the case one or more events of default occurs, then and in every such case the registered Bondholder is entitled to proceed to protect and enforce such registered Bondholder’s rights by such appropriate judicial proceeding as such registered Bondholder deems most effectual to protect and

enforce any such right, whether by mandamus or other suit or proceeding at law or in equity, for the specific performance of any covenant or agreement contained in the Resolutions authorizing the Bonds, as more specifically set forth in each Resolution authorizing the Bonds pursuant to the respective Bond Acts. Beneficial owners of the Bonds (the “Beneficial Owners”) cannot protect and enforce such rights except through the registered Bondholder. See “THE BONDS—General,” and APPENDIX B—“DTC AND THE BOOK—ENTRY SYSTEM.”

### **Bond Insurance for Bonds Maturing on September 1, 2013 through September 1, 2016 Only**

*The following information has been furnished by MBIA Insurance Corporation (“MBIA”) for use in this Official Statement. Reference is made to APPENDIX E for a specimen of MBIA’s financial guaranty insurance policy (the “MBIA Policy”). No representation is made by the State or Co-Bond Counsel as to the accuracy or completeness of the following information.*

*The MBIA Insurance Corporation Insurance Policy.* MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the MBIA Policy and MBIA set forth under the heading “AUTHORIZATION AND SECURITY FOR THE BONDS—Bond Insurance for Bonds Maturing on September, 2013 through September 1, 2016 Only.” Additionally, MBIA makes no representation regarding the Bonds maturing on September 1, 2013, September 1, 2014, September 1, 2015 and September 1, 2016 (the “MBIA Insured Bonds”) or the advisability of investing in the Bonds.

The MBIA Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the Authority to the Trustee or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the MBIA Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the MBIA Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless MBIA elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner of the MBIA Insured Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law (a “Preference”).

The MBIA Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any MBIA Insured Bonds. The MBIA Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of MBIA Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The MBIA Policy also does not insure against nonpayment of principal of or interest on the MBIA Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Trustee or any other paying agent for the MBIA Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Trustee or any owner of a MBIA Insured Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or



its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such MBIA Insured Bonds or presentment of such other proof of ownership of the MBIA Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the MBIA Insured Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the MBIA Insured Bonds in any legal proceeding related to payment of insured amounts on the MBIA Insured Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Trustee payment of the insured amounts due on such MBIA Insured Bonds, less any amount held by the Trustee for the payment of such insured amounts and legally available therefor.

*MBIA Insurance Corporation.* MBIA is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the “Company”). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA, either directly or through subsidiaries, is licensed to do business in the Republic of France, the United Kingdom and the Kingdom of Spain and is subject to regulation under the laws of those jurisdictions.

The principal executive offices of MBIA are located at 113 King Street, Armonk, New York 10504 and the main telephone number at that address is (914) 273-4545.

*Regulation.* As a financial guaranty insurance company licensed to do business in the State of New York, MBIA is subject to the New York Insurance Law which, among other things, prescribes minimum capital requirements and contingency reserves against liabilities for MBIA, limits the classes and concentrations of investments that are made by MBIA and requires the approval of policy rates and forms that are employed by MBIA. State law also regulates the amount of both the aggregate and individual risks that may be insured by MBIA, the payment of dividends by MBIA, changes in control with respect to MBIA and transactions among MBIA and its affiliates.

The MBIA Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

*Financial Strength Ratings of MBIA.* Moody’s Investors Service, Inc. rates the financial strength of MBIA “Aaa.”

Standard & Poor’s, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA “AAA.”

Fitch Ratings rates the financial strength of MBIA “AAA.”

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency’s current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the MBIA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the MBIA Insured Bonds. MBIA does not guaranty the market price of the MBIA Insured Bonds nor does it guaranty that the ratings on the MBIA Insured Bonds will not be revised or withdrawn.

*MBIA Financial Information.* As of December 31, 2005, MBIA had admitted assets of \$11.0 billion (unaudited), total liabilities of \$7.2 billion (unaudited), and total capital and surplus of \$3.8 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of June 30, 2006 MBIA had admitted assets of \$11.3 billion (unaudited), total liabilities of \$6.9 billion (unaudited), and total capital and surplus of \$4.3 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning MBIA, see the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2005 and December 31, 2004 and for each of the three years in the period ended December 31, 2005, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of the Company for the year ended December 31, 2005 and the consolidated financial statements of MBIA and its subsidiaries as of March 31, 2006 and for the three month period ended June 30, 2006 and June 30, 2005 included in the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2006, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

Copies of the statutory financial statements filed by MBIA with the State of New York Insurance Department are available over the Internet at the Company's web site at <http://www.mbia.com> and at no cost, upon request to MBIA at its principal executive offices.

*Incorporation of Certain Documents by Reference.* The following documents filed by the Company with the Securities and Exchange Commission (the "SEC") are incorporated by reference into this Official Statement:

- (1) The Company's Annual Report on Form 10-K for the year ended December 31, 2005; and
- (2) The Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.

Any documents, including any financial statements of MBIA and its subsidiaries that are included therein or attached as exhibits thereto, filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the Company's most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K/A, and prior to the termination of the offering of the MBIA Insured Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the Company's SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2005, and (2) the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006, June 30, 2006 are available (i) over the Internet at the SEC's web site at <http://www.sec.gov>; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at <http://www.mbia.com>; and (iv) at no cost, upon request to MBIA at its principal executive offices.

In the event the Company were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

### **Bond Insurance for Bonds Maturing on September 1, 2022 and September 1, 2026 Only**

*The following information has been furnished by Financial Security Assurance Inc. ("FSA" or "Financial Security") for use in this Official Statement. Reference is made to APPENDIX F for a specimen of FSA's municipal bond insurance policy (the "FSA Policy"). No representation is made by the State or Co-Bond Counsel as to the accuracy or completeness of the following information.*

Other than with respect to information concerning Financial Security contained under this caption "–Bond Insurance for Bonds Maturing on September 1, 2022 and September 1, 2026 Only" and the FSA Policy set forth in APPENDIX F—"SPECIMEN FSA POLICY," none of the information in this Official Statement has been supplied or verified by Financial Security and Financial Security makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Bonds; or (iii) the tax exempt status of the interest on the Bonds

*Bond Insurance Policy.* Concurrently with the issuance of the Bonds, Financial Security Assurance Inc. ("Financial Security") will issue the FSA Policy for the Bonds maturing on September 1, 2022 and September 1, 2026 (the "FSA Insured Bonds"). The FSA Policy guarantees the scheduled payment of principal of and interest on the FSA Insured Bonds when due as set forth in the form of the FSA Policy included in APPENDIX E this Official Statement.

The FSA Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

*Financial Security Assurance Inc.* Financial Security is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or Financial Security is liable for the obligations of Financial Security.

At June 30, 2006, Financial Security's combined policyholders' surplus and contingency reserves were approximately \$2,514,378,000 and its total net unearned premium reserve was approximately \$1,937,740,000 in accordance with statutory accounting principles. At June 30, 2006, Financial Security's consolidated shareholder's equity was approximately \$2,889,984,000 and its total net unearned premium reserve was approximately \$1,556,639,000 in accordance with generally accepted accounting principles.

The consolidated financial statements of Financial Security included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of Financial Security included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the FSA Insured Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The FSA Policy does not protect investors against changes in market value of the FSA Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. Financial Security makes no representation regarding the FSA Insured Bonds or the advisability of investing in the FSA Insured Bonds. Financial Security makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that Financial Security has provided to the Issuer the information presented under this caption for inclusion in the Official Statement.

### **Bond Insurance for Bonds Maturing on September 1, 2033 Only**

*The following information has been furnished by Ambac Assurance Corporation (“Ambac”) for use in this Official Statement. Reference is made to APPENDIX G for a specimen of Ambac’s financial guaranty insurance policy (the “Ambac Policy”). No representation is made by the State or Co-Bond Counsel as to the accuracy or completeness of the following information.*

Ambac has made a commitment to issue the Ambac Policy relating to the Bonds Maturing on September 1, 2033 (the “Ambac Insured Bonds”) effective as of the date of delivery of the Ambac Insured Bonds. Under the terms of the Ambac Policy, Ambac will pay to The Bank of New York, New York, New York or any successor thereto (the “Insurance Trustee”) that portion of the principal of and interest on the Ambac Insured Bonds which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the State (as such terms are defined in the Ambac Policy). Ambac will make such payments to the Insurance Trustee on the later of the date on which such principal and interest becomes Due for Payment or within one business day following the date on which Ambac shall have received notice of Nonpayment from the State. The insurance will extend for the term of the Ambac Insured Bonds and, once issued, cannot be canceled by Ambac.

The Ambac Policy will insure payment only on stated maturity dates, in the case of principal, and on stated dates for payment, in the case of interest. If the Ambac Insured Bonds become subject to mandatory redemption and insufficient funds are available for redemption of all outstanding Ambac Insured Bonds, Ambac will remain obligated to pay principal and interest with respect to outstanding Ambac Insured Bonds on the originally scheduled interest and principal payment dates. In the event of any acceleration of the principal of the Ambac Insured Bonds, the insured payments will be made at such times and in such amounts as would have been made had there not been an acceleration, except to the extent that Ambac elects, in its sole discretion, to pay all or a portion of the accelerated principal and interest accrued thereon to the date of acceleration (to the extent unpaid by the Ambac Insured Bonds). Upon payment of all such accelerated principal and interest accrued to the acceleration date, Ambac’s obligations under the Ambac Policy shall be fully discharged.

In the event the Trustee has notice that any payment of principal or interest with respect to an Ambac Insured Bond which has become Due for Payment and which is made to an owner of an Ambac Insured Bond by or on behalf of the State has been deemed a preferential transfer and theretofore recovered from its owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such owner will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

The Ambac Policy does not insure any risk other than Nonpayment, as defined in the Policy. Specifically, the Ambac Policy does not cover:

1. payment on acceleration, as a result of a call for redemption or as a result of any other advancement of maturity.
2. payment of any redemption, prepayment or acceleration premium.

3. nonpayment of principal or interest caused by the insolvency or negligence of any of the State, a paying agent or a bond registrar, if any.

If it becomes necessary to call upon the Ambac Policy, payment of principal requires surrender of Ambac Insured Bonds to the Insurance Trustee together with an appropriate instrument of assignment so as to permit ownership of such Ambac Insured Bonds to be registered in the name of Ambac to the extent of the payment under the Ambac Policy. Payment of interest pursuant to the Ambac Policy requires proof of owner entitlement to interest payments and an appropriate assignment of the owner's right to payment to Ambac.

Upon payment of the insurance benefits, Ambac will become the owner of the Ambac Insured Bond, appurtenant coupon, if any, or right to payment of principal or interest on such Ambac Insured Bond and will be fully subrogated to the surrendering owner's rights to payment.

In the event that Ambac were to become insolvent, any claims arising under the Ambac Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

Ambac is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam, the Commonwealth of Puerto Rico and the U.S. Virgin Islands, with admitted assets of approximately \$9,599,000,000 (unaudited) and statutory capital of \$6,000,000,000 (unaudited) as of June 30, 2006. Statutory capital consists of Ambac's policyholders' surplus and statutory contingency reserve. Standard & Poor's Credit Markets Services, a Division of The McGraw-Hill Companies, Moody's Investors Service and Fitch Ratings have each assigned a triple-A financial strength rating to Ambac.

Ambac has obtained a ruling from the Internal Revenue Service to the effect that the insuring of an obligation by Ambac will not affect the treatment for federal income tax purposes of interest on such obligation and that insurance proceeds representing maturing interest paid by Ambac under policy provisions substantially identical to those contained in the Ambac Policy shall be treated for federal income tax purposes in the same manner as if such payments were made by the obligor of the obligation.

Ambac makes no representation regarding the Ambac Insured Bonds or the advisability of investing in the Ambac Insured Bonds and makes no representation regarding, nor has it participated in the preparation of, the Official Statement other than the information supplied by Ambac and presented under the heading "AUTHORIZATION AND SECURITY FOR THE BONDS—Bond Insurance for the Bonds Maturing on September 1, 2033 Only."

*Available Information Regarding Ambac.* The parent company of Ambac, Ambac Financial Group, Inc. (the "Company"), is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). These reports, proxy statements and other information can be read and copied at the SEC's public reference room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC maintains an internet site at <http://www.sec.gov> that contains reports, proxy and information statements and other information regarding companies that file electronically with the SEC, including the Company. These reports, proxy statements and other information can also be read at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005.

Copies of Ambac's financial statements prepared in accordance with statutory accounting standards are available from Ambac. The address of Ambac's administrative offices and its telephone number are One State Street Plaza, 19th Floor, New York, New York, 10004 and (212) 668-0340.

*Incorporation of Certain Documents by Reference.* The following documents filed by the Company with the SEC (File No. 1-10777) are incorporated by reference in this Official Statement:

1. The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 and filed on March 13, 2006;
2. The Company's Current Report on Form 8-K dated and filed on April 26, 2006;
3. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended March 31, 2006 and filed on May 10, 2006;
4. The Company's Current Report on Form 8-K dated July 25, 2006 and filed on July 26, 2006;
5. The Company's Current Report on Form 8-K dated and filed on July 26, 2006; and
6. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 2006 and filed on August 9, 2006.

All documents subsequently filed by the Company pursuant to the requirements of the Exchange Act after the date of this Official Statement will be available for inspection in the same manner as described above in "–Available Information Regarding Ambac."

## **THE BONDS**

### **General**

The Bonds will be registered in the name of a nominee of DTC, which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only in denominations of \$5,000 or any integral multiple thereof. See APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM." The information in APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM" has been furnished by DTC and no representation is made by the State, the Financial Advisor or the initial purchaser as to the accuracy or completeness of such information.

Neither the State Treasurer nor the initial purchaser can or does give any assurances that DTC will distribute to Participants, or that Participants or others will distribute to the Beneficial Owners, payment of principal of and interest on the Bonds paid or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. Neither the State Treasurer nor the initial purchaser is responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the Bonds or any error or delay relating thereto.

The Bonds will be dated September 1, 2006 and will mature on September 1 of the years and in the amounts set forth on the inside cover page hereof. Interest on the Bonds is payable on March 1 and September 1 in each year (each, an "Interest Payment Date"), commencing on March 1, 2007, at the rates

shown on the inside cover page of this Official Statement. Interest on the Bonds will be calculated on the basis of a 360-day year comprising twelve 30-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the Participants in DTC for disbursement to the Beneficial Owners of the Bonds. The record date for the payment of interest on the Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the record date falls on a business day.

### **Identification and Authorization of the Bonds**

The Bonds are being issued to current refund certain outstanding State general obligation commercial paper notes (the "Notes") issued to finance various projects under the respective Bond Acts identified below to repay interim loans from the State's Pooled Money Investment Account that financed construction of various projects under the respective Bond Acts identified below, finance various projects under the respective Bond Acts identified below and to pay certain costs of issuance of the Bonds. The Bonds are issued as seventeen separate series under fifteen separate Bond Acts, each authorized by the voters, as set forth below:

\$7,000,000 principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bonds, Series U, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Act of 2000 (The Villaraigosa-Keeley Act).

\$7,000,000 principal amount of State of California Safe, Clean, Reliable Water Supply Bonds, Series Y, authorized by the Safe, Clean, Reliable Water Supply Finance Committee under the Safe, Clean, Reliable Water Supply Act.

\$20,930,000 principal amount of State of California Class Size Reduction Kindergarten-University Public Education Facilities Bonds, Series BQ, authorized by the Higher Education Facilities Finance Committee under the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998.

\$310,000 principal amount of State of California Seismic Retrofit Bonds, Series AG, authorized by the Seismic Retrofit Finance Committee under the Seismic Retrofit Bond Act of 1996.

\$2,500,000 principal amount of State of California Clean Air and Transportation Improvement Bonds, Series AV, authorized by the Transportation Improvement Finance Committee under the Clean Air and Transportation Improvement Act of 1990.

\$1,000,000 principal amount of State of California School Facilities Bonds, Series AK, authorized by the State School Building Finance Committee under the Schools Facilities Bond Act of 1992.

\$670,000 principal amount of State of California Water Conservation Bonds, Series T, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

\$15,000 principal amount of State of California Safe Drinking Water Bonds, Series S, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

\$32,500,000 principal amount of State of California Reading and Literacy Improvement and Public Library Construction and Renovation Bonds, Series G, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

\$10,500,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series Y, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

\$5,000,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series Z, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

\$146,500,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series Z, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

\$102,500,000 principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Bonds, Series K, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

\$25,000,000 principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Bonds, Series J, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

\$103,500,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series M, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

\$326,575,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series L, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

\$8,500,000 principal amount of State of California Children's Hospital Bonds, Series B, authorized by the Children's Hospital Bond Act Finance Committee under the Children's Hospital Bond Act of 2004.

### **Purposes of the Bonds**

The Bonds are being issued to current refund certain outstanding Notes under the respective Bond Acts, repay interim loans from the State's Pooled Money Investment Account that financed construction of various projects under the respective Bond Acts, finance various projects under the respective Bond Acts and pay certain costs of issuance of the Bonds. The Notes will be repaid within 90 days after the issuance of the Bonds so as to constitute a "current refunding" for federal tax purposes.



## Redemption Provisions

### *Optional Redemption of Bonds*

The Bonds maturing on or before September 1, 2016 are not subject to optional redemption prior to their respective maturities. The Bonds maturing on and after September 1, 2017 are subject to optional redemption prior to their respective stated maturity dates, in whole or in part, in such order of maturity as may be designated by the State Treasurer and by lot within any maturity, on any date on or after September 1, 2016 at a redemption price equal to 100% of the principal amount thereof, plus accrued interest to the date fixed for redemption.

### *Sinking Fund Redemption*

The Bonds maturing on September 1, 2036 (the “Term Bonds”) are subject to redemption prior to their stated maturity date, in part, by lot, from sinking fund payments made by the State, at a redemption price of 100% of the principal amount thereof plus accrued interest to the sinking fund payment date fixed for redemption, without premium, on September 1 of the years, and in the amounts designated below for the Bonds:

#### **Term Bonds Due September 1, 2036**

<b>Sinking Fund Payment Date (September 1)</b>	<b>Principal Amount Redeemed</b>
2034	\$45,200,000
2035	50,100,000
2036 <sup>†</sup>	54,600,000

<sup>†</sup> Final Maturity.

If a Term Bond is called for optional redemption in part (see “Optional Redemption of Bonds” above), the remaining sinking fund installments for such Term Bonds shall be adjusted as determined by the State Treasurer.

### *Notice of Redemption*

When redemption is required while the Bonds are in book–entry form, the State Treasurer is to give notice of redemption by mailing copies of such notice only to DTC (not to the Beneficial Owners of the Bonds) not less than 30 or more than 60 days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the Beneficial Owners of the Bonds. See APPENDIX B–“DTC AND THE BOOK–ENTRY SYSTEM.” The notice from the State Treasurer will state, among other things, that the Bonds or a designated portion thereof (in the case of partial redemption of a Bond) are to be redeemed, the dated date of the Bonds, the date fixed for redemption, the maturities of the Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption no further interest will accrue on the principal of any Bonds called for redemption. The notice of redemption may also state that such redemption may be cancelled in whole or in part by the State Treasurer upon written notice to DTC no later than five business days prior to the date fixed for redemption. Notice of redemption will also be provided by mail to certain financial information services and securities depositories.

## Annual Debt Service Requirements

The following table sets forth the amounts required to be made available for the payment of principal (whether at maturity or by sinking fund payments), interest and the total payments due on the Bonds.

Fiscal Year Ended June 30	Principal	Interest	Fiscal Year Total Debt Service
2007	—	\$18,890,625.00	\$18,890,625.00
2008	\$12,000,000	37,511,250.00	49,511,250.00
2009	9,500,000	37,003,750.00	46,503,750.00
2010	13,800,000	36,421,250.00	50,221,250.00
2011	19,300,000	35,569,625.00	54,869,625.00
2012	25,600,000	34,423,000.00	60,023,000.00
2013	33,000,000	32,958,000.00	65,958,000.00
2014	35,600,000	31,421,000.00	67,021,000.00
2015	31,600,000	30,077,000.00	61,677,000.00
2016	32,500,000	28,795,000.00	61,295,000.00
2017	30,800,000	27,375,000.00	58,175,000.00
2018	30,900,000	25,832,500.00	56,732,500.00
2019	34,300,000	24,202,500.00	58,502,500.00
2020	35,100,000	22,467,500.00	57,567,500.00
2021	28,200,000	20,885,000.00	49,085,000.00
2022	22,600,000	19,615,000.00	42,215,000.00
2023	12,100,000	18,792,875.00	30,892,875.00
2024	12,300,000	18,228,250.00	30,528,250.00
2025	13,500,000	17,583,250.00	31,083,250.00
2026	17,100,000	16,818,250.00	33,918,250.00
2027	16,800,000	16,033,750.00	32,833,750.00
2028	23,500,000	15,089,250.00	38,589,250.00
2029	20,700,000	13,984,250.00	34,684,250.00
2030	20,200,000	12,961,750.00	33,161,750.00
2031	21,900,000	11,936,625.00	33,836,625.00
2032	29,100,000	10,689,000.00	39,789,000.00
2033	30,300,000	9,204,000.00	39,504,000.00
2034	37,800,000	7,596,000.00	45,396,000.00
2035 <sup>†</sup>	45,200,000	5,728,500.00	50,928,500.00
2036 <sup>†</sup>	50,100,000	3,584,250.00	53,684,250.00
2037	54,600,000	1,228,500.00	55,828,500.00
Total	\$800,000,000	\$642,906,500.00	\$1,442,906,500.00

<sup>†</sup> Mandatory sinking fund payment.

## **Supplemental Resolutions**

The State may modify or amend the Resolutions with respect to any outstanding Bonds and the rights and obligations of the Holders of such outstanding Bonds and the State at any time by a Supplemental Resolution, without notice to or the consent of any Holder, but only to make such provisions for the purpose of (i) curing any ambiguity, curing, correcting or supplementing any defective provision contained in the Resolutions, or (ii) complying with requirements of the Code in order to satisfy the covenants of the Resolutions relating to tax exemption of interest on the Bonds; in each case as the applicable finance committee may deem necessary or desirable and not inconsistent with the Resolutions, and which shall not adversely affect the interests of the Holders of the affected Bonds.

## **Defeasance**

Pursuant to the Bond Acts and the provisions of California Government Code Section 16780 et seq. (the “Refunding Law”), refunding bonds may be issued to refund outstanding Bonds at or prior to their stated maturity. Pursuant to Government Code Section 16784 of the Refunding Law, the proceeds of such refunding Bonds shall be deposited into the Refunding Escrow Fund of the State Treasury, which Fund is irrevocably dedicated to pay the principal of, premium, if any, and interest on the refunded Bonds as it comes due. If Defeasance Obligations sufficient to pay all of the principal of, premium, if any, and interest on the refunded Bonds to their maturity or date fixed for redemption are so deposited in the Refunding Escrow Fund, the refunded Bonds will no longer be deemed outstanding for purposes of the Resolution. Except in the case of the defeasance of Bonds by the deposit of the full amount of the principal and interest due until redemption or maturity, the sufficiency of the deposit in the Fund will be verified by a firm of independent public accountants.

The Resolutions relating to the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Act of 2000 (The Villaraigosa-Keeley Act), the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000, the Kindergarten-University Public Education Facilities Bond Act of 2002 and the Kindergarten-University Public Education Facilities Bond Act of 2004 (see “–Identification and Authorization of the Bonds” above) specifically define “Defeasance Obligations” for these purposes as follows: (i) bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest, including receipts, certificates or any other evidences of an ownership interest in (i) or in specified portions thereof, which are rated in the highest rating category by each rating agency rating such obligations; (ii) bonds or interest-bearing notes or obligations that are guaranteed as to principal and interest by a federal agency of the United States; (iii) pre-refunded municipal bonds which are rated in the highest rating category by each rating agency rating such bonds; (iv) bonds, consolidated bonds, collateral trust debentures, consolidated debentures or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended; debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended; bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act; bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act as amended and bonds of any federal home loan bank established under that act; obligations of the Federal Home Loan Mortgage Corporation; bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act as amended; and bonds, notes and other obligations guaranteed by the Commodity Credit Corporation for the export of California agricultural products under the Commodity Credit Corporation Charter Act as amended, provided, however that the Defeasance Obligations specified in this paragraph (iv) shall be rated by at least two of any three rating agencies rating such obligations not lower than the higher of (1) the rating on the Bonds to be defeased at the time of the original issuance thereof and (2) the rating on the Bonds to be defeased at the time of defeasance;

(v) deposit in the State Surplus Money Investment Fund; or (vi) any other investment designated in a Supplemental Certificate as a Defeasance Obligation for purposes of defeasing the Bonds authorized by such Supplemental Certificate, provided that each rating agency has confirmed in writing to the Treasurer that the use of such other investment will not, by itself, result in the withdrawal, suspension or downgrade of any rating issued by such rating agency with respect to any such Bonds defeased.

## **LEGAL MATTERS**

The opinion of the Honorable Bill Lockyer, Attorney General of the State of California (the “Attorney General”), approving the validity of the Bonds will accompany the Bonds deposited with DTC. The opinions of Orrick, Herrington & Sutcliffe LLP and Lofton & Jennings, Co-Bond Counsel to the State, approving the validity of the Bonds and addressing certain tax matters will also accompany the Bonds deposited with DTC. The proposed forms of legal opinions for the Bonds are set forth in APPENDIX D. See “TAX MATTERS” and APPENDIX D–“PROPOSED FORMS OF LEGAL OPINIONS.” Orrick, Herrington & Sutcliffe LLP served as Disclosure Counsel to the State.

The Attorney General and Co-Bond Counsel, respectively, undertake no responsibility for the accuracy, completeness or fairness of this Official Statement.

## **TAX MATTERS**

In the opinion of Orrick, Herrington & Sutcliffe LLP and Lofton & Jennings, Co-Bond Counsel to the State, based upon an analysis of existing laws, regulations, rulings, and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the “Code”) and is exempt from State of California personal income taxes. Co-Bond Counsel are of the further opinion that such interest is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Co-Bond Counsel observe that such interest is included in adjusted current earnings when calculating federal corporate alternative minimum taxable income. A complete copy of the proposed form of opinions of Co-Bond Counsel is set forth in APPENDIX D–“PROPOSED FORMS OF LEGAL OPINIONS.”

The amount (if any) by which the issue price of the Bonds of any given maturity date is less than the amount to be paid on such date (excluding amounts stated to be interest and payable at least annually over term of such Bonds) constitutes “original issue discount,” the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Bonds which is excluded from gross income for federal income tax purposes and exempt from State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Bonds is the first price at which a substantial amount of such maturity of the Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to Bonds of any maturity date accrues daily over the term to such maturity date on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Bonds. Beneficial Owners of the Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Bonds with original issue discount, including the treatment of purchasers who do not purchase such Bonds in the original offering to the public at the first price which a substantial amount of such Bonds is sold to the public.

Any Bonds purchased, whether at original issuance or otherwise, for an amount greater than their principal amount payable at maturity (or, in some cases, at their earlier call date) (“Premium Bonds”) will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of obligations, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner’s basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Bonds. The State has made certain representations and covenanted to comply with certain restrictions, conditions, and requirements designed to ensure that interest on the Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Bonds being included in gross income for federal income tax purposes, possibly from the date of original delivery of the Bonds. The opinions of Co-Bond Counsel assume compliance with these covenants. Co-Bond Counsel have not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) or any other matters coming to the attention of Co-Bond Counsel after the date of delivery of the Bonds may adversely affect the value of, or the tax status of interest on, the Bonds.

Although Co-Bond Counsel are of the opinion that interest on the Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the Bonds may otherwise affect a beneficial owner’s federal or state tax liability. The nature and extent of these other tax consequences will depend upon the particular tax status of the beneficial owner or the beneficial owner’s other items of income or deduction. Co-Bond Counsel express no opinion regarding any such other tax consequences.

Future legislation, if enacted into law, or clarification of the Code may cause interest on the Bonds to be subject, directly or indirectly, to federal income taxation or otherwise prevent Beneficial Owners of the Bonds from realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such future legislation or clarification of the Code may also affect the market price for, or marketability of, the Bonds. Prospective purchasers of the Bonds should consult their own tax advisers regarding any pending or proposed federal tax legislation, as to which Co-Bond Counsel expresses no opinion.

The opinions of Co-Bond Counsel are based on current legal authority, cover certain matters not directly addressed by such authorities, and represent Co-Bond Counsel’s judgment as to the proper treatment of the Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service (“IRS”) or the courts. Co-Bond Counsel cannot give and have not given any opinion or assurance about the future activities of the State, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or changes in enforcement thereof by the IRS. The State has covenanted, however, to comply with the requirements of the Code.

Co-Bond Counsel’s engagement with respect to the Bonds ends with the issuance of the Bonds, and, unless separately engaged, Co-Bond Counsel are not obligated to defend the State or the Beneficial Owners regarding the tax-exempt status of the Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the State and their appointed counsel, including the Beneficial Owners, would have little if any right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt

bonds is difficult, obtaining an independent review of IRS positions with which the State legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the Bonds, and may cause the State or the Beneficial Owners to incur significant expense.

## **LITIGATION**

The Attorney General has advised that to his knowledge there is not now pending (with service of process on the State having been accomplished) or threatened any litigation seeking to restrain or enjoin the sale, issuance, execution or delivery of the Bonds or challenging the validity of the Bonds or any proceedings of the State taken with respect to the foregoing.

At any given time, including the present, there are numerous civil actions pending against the State, which could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues and cash flow. While there can be no assurances as to the ultimate outcome and fiscal impact of such litigation, the State believes that it is unlikely that the outcome of any such litigation could adversely affect the ability of the State to pay the principal of and interest on the Bonds when due. See APPENDIX A—"THE STATE OF CALIFORNIA—LITIGATION."

## **FINANCIAL STATEMENTS**

Audited Basic Financial Statements of the State (the "Financial Statements") for the Fiscal Year ended June 30, 2005 are available. The Financial Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories, as part of an Official Statement relating to the \$700,000,000 Various Purpose General Obligation Bonds and \$314,135,000 General Obligation Refunding Bonds issued in June 2006. The Financial Statements are incorporated by reference into this Official Statement. The Financial Statements are also available through electronic means. No such information is a part of or incorporated into this Official Statement, except as expressly noted in APPENDIX A—"THE STATE OF CALIFORNIA—FINANCIAL STATEMENTS." Certain unaudited financial information for the twelve months ended June 30, 2006 and for the one month ended July 31, 2006 is included as Exhibits to APPENDIX A. See APPENDIX A—"THE STATE OF CALIFORNIA—FINANCIAL STATEMENTS."

## **RATINGS**

The MBIA Insured Bonds, the FSA Insured Bonds and the Ambac Insured Bonds have received the ratings of "Aaa" by Moody's Investors Service ("Moody's"), "AAA" by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. ("S&P"), and "AAA" by Fitch Ratings ("Fitch"). The uninsured Bonds have received the ratings of "A1" by Moody's, "A+" by S&P and "A+" by Fitch. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant. Any revision or withdrawal of a credit rating could have an effect on the market prices and marketability of the Bonds. The State can not predict the timing or impact of future actions by the rating agencies. See APPENDIX A—"THE STATE OF CALIFORNIA—INTRODUCTION TO APPENDIX A—California's Credit and Rating History."

## **FINANCIAL ADVISOR**

Public Resources Advisory Group served as the Financial Advisor to the State in connection with the issuance of the Bonds.

## **ADDITIONAL INFORMATION**

The State Treasurer will execute a certificate upon delivery of the Bonds to the effect that, to the best of the State Treasurer's knowledge, information and belief, as of the delivery date, the information and statements contained in this Official Statement are complete, true and correct in all material respects and does not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

STATE OF CALIFORNIA  
**PHILIP ANGELIDES**  
Treasurer of the State of California

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APPENDIX A

THE STATE OF CALIFORNIA



*Honorable Philip Angelides*

*Treasurer of the State of California*

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## INTRODUCTION TO APPENDIX A

**Importance of APPENDIX A.** APPENDIX A is the part of the Official Statement that provides investors with information concerning the State of California. Investors are advised to read the entire Official Statement, including APPENDIX A, to obtain information essential to making an informed investment decision. Certain abbreviations and defined terms are shown at the end of this Introduction.

**Payment Priority of General Obligation Bonds.** The Bonds are general obligations of the state to which the full faith and credit of the state are pledged. Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the state, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education.

**California's Credit and Rating History.** California has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

After reaching their lowest point in 2003, the ratings of the state's general obligation bonds have been raised by all three rating agencies starting in 2004. Standard & Poor's has raised the state's general obligation credit rating from "BBB" to "A+." Moody's has raised the rating from "Baa1" to "A1." Fitch has raised the rating from "BBB" to "A+." The most recent actions by Moody's and S&P both took place in May, 2006 and the latest action by Fitch took place in June, 2006.

Any revisions or withdrawal of a credit rating could have an effect on the market price and liquidity of the Bonds. The state cannot predict the timing or impact of future actions by the rating agencies. See also "RATINGS" in the forepart of this Official Statement.

**Overview of APPENDIX A.** Following the Introduction, APPENDIX A begins with a discussion of certain recent developments and a description of the types of debt instruments that the state has issued and is authorized to issue in the future. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS." A discussion of the state's current and projected cash flow is contained under "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings."

APPENDIX A continues with a discussion of the sources and uses of state funds. See "STATE FINANCES." The budget process and constraints on this process, as well as the budget proposed by the Governor and the economic assumptions underlying the revenue projections contained in the proposed budget, are discussed under "THE BUDGET PROCESS" and "CURRENT STATE BUDGET."

APPENDIX A incorporates by reference the Audited Basic Financial Statements of the state for the Year Ended June 30, 2005, together with certain information required by governmental accounting and financial reporting standards to be included in the Financial Statements, including a "Management's Discussion and Analysis" that describes and analyzes the financial position of the state and provides an overview of the state's activities for the fiscal year ended June 30, 2005. In addition, APPENDIX A contains the State Controller's unaudited reports of cash receipts and disbursements for the periods after June 30, 2005. See "FINANCIAL STATEMENTS."

Governance, management and employee information is set forth under "OVERVIEW OF STATE GOVERNMENT." Demographic and economic statistical information is included under "ECONOMY AND POPULATION." APPENDIX A concludes with a description of material litigation involving the state (see "LITIGATION") and debt tables (see "STATE DEBT TABLES").

**Certain Defined Terms.** The following terms and abbreviations are used in this APPENDIX A:

“2004 Budget Act” means the Budget Act for the 2004-05 Fiscal Year, adopted on July 31, 2004.

“2005-06 Governor’s Budget” means the Governor’s Proposed Budget for the 2005-06 Fiscal Year, released on January 10, 2005.

“2005-06 May Revision” means the May Revision of the 2005-06 Governor’s Budget, released on May 13, 2005.

“2005 Budget Act” means the Budget Act for the 2005-06 Fiscal Year, adopted on July 11, 2005.

“2006-07 Governor’s Budget” means the Governor’s Proposed Budget for the 2006-07 Fiscal Year, released on January 10, 2006.

“2006-07 May Revision” means the May Revision of the 2006-07 Governor’s Budget, released on May 12, 2006.

“2006 Budget Act” means the Budget Act for the 2006-07 Fiscal Year, adopted on June 30, 2006.

Reference to the “state” as a noun or adjective means the State of California, following the practice of the Department of Finance.

## **RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES**

This section discusses certain significant developments regarding the state’s economy or finances which have occurred since the date of the Official Statement, dated June 14, 2006, relating to \$700,000,000 State of California Various Purpose General Obligation Bonds and \$314,135,000 General Obligation Refunding Bonds. Investors are advised to read this entire Appendix A.

Governor Schwarzenegger signed the 2006 Budget Act and related legislation on June 30, 2006. The 2006 Budget Act enacted a spending plan of about \$131.4 billion, of which \$101.3 billion will be from the General Fund, an increase of 9.2 percent over the prior year. The Governor vetoed spending of about \$112 million (\$62 million General Fund). General Fund revenues and transfers are projected to be about \$93.9 billion, a 1.2 percent increase. The difference will be made up by applying a portion of the \$9.0 billion reserve at June 30, 2006. While the “operating shortfall” between revenues and expenditures is \$7.4 billion, the Administration states that \$2.1 billion will go into reserves, and another \$2.8 billion will be used to repay and prepay prior budgetary loans, leaving a much smaller “effective operating deficit.” The 2006 Budget Act also included Special Fund expenditures of \$26.6 billion and Bond Fund expenditures of \$3.6 billion.

The 2006 Budget Act closely resembled the plan presented by the Governor in the 2006-07 May Revision. See “CURRENT STATE BUDGET – 2006 Budget Act”.

## **STATE INDEBTEDNESS AND OTHER OBLIGATIONS**

### **General**

The State Treasurer is responsible for the sale of debt obligations of the state and its various authorities and agencies. The state has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

## **Capital Facilities Financing**

### *General Obligation Bonds*

The State Constitution prohibits the creation of general obligation indebtedness of the state unless a bond measure is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See “STATE FINANCES—State Expenditures.” Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of July 1, 2006, the state had outstanding \$48,785,822,000 aggregate principal amount of long-term general obligation bonds, of which \$37,066,227,000 were payable primarily from the state’s General Fund, and \$11,719,595,000 were payable from other revenue sources. See “Economic Recovery Bonds” below. As of July 1, 2006, there were unused voter authorizations for the future issuance of \$31,037,291,000 of long-term general obligation bonds. This latter figure consists of \$16,919,251,000 of general obligation bonds which are authorized by state finance committees to be issued initially as commercial paper notes, described below, and \$14,118,040,000 of other authorized but unissued general obligation bonds. Of this unissued amount, \$4,399,185,000 is for bonds payable from other revenue sources (of which \$115,570,000 is authorized for commercial paper notes). See the table “Authorized and Outstanding General Obligation Bonds” under “STATE DEBT TABLES.”

General obligation bond law permits the state to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. The state had outstanding \$7,344,565,000 variable rate general obligation bonds (which includes the economic recovery bonds), representing about 15.1 percent of the state’s total outstanding general obligation bonds as of July 1, 2006.

### *Proposed General Obligation Bond Measures*

In response to the Governor's proposal for a \$220 billion infrastructure investment plan, which would have used \$68 billion in new general obligation bonds, the Legislature approved four bond measures, totaling approximately \$37.3 billion, to appear on the November, 2006 general election ballot. These four measures are for the following programs:

- \$19,925,000,000 for transportation improvements, air quality and port security
- \$10,416,000,000 for K-12 school modernization and construction (\$7.3 billion), and higher education facilities (\$3.1 billion)
- \$4,090,000,000 for flood control and prevention, levee repair and similar costs
- \$2,850,000,000 for housing and related programs

An initiative measure to approve approximately \$5.4 billion of bonds for water quality, flood control, parks and similar facilities will appear as Proposition 84 on the November 2006 ballot. A \$9.95 billion bond measure for high speed rail projects has been moved from the November 2006 general election until the 2008 general election.

### Commercial Paper Program

Pursuant to legislation enacted in 1995, voter-approved general obligation indebtedness may be issued either as long-term bonds or, for some but not all bond issues, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The state issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Commercial paper notes are deemed outstanding upon authorization by the respective finance committees, whether or not such notes are actually issued. Pursuant to the terms of the bank credit agreement presently in effect, the general obligation commercial paper program may have up to \$1.5 billion in aggregate principal and interest commitments at any time. This amount may be increased or decreased in the future. As of July 1, 2006, the finance committees had authorized the issuance of up to \$16,919,251,000 of commercial paper notes and, as of that date, \$330,550,000 aggregate principal amount of general obligation commercial paper notes were issued. See “STATE DEBT TABLES” for information on the current outstanding amount of commercial paper notes.

### Lease-Purchase Obligations

In addition to general obligation bonds, the state builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another state or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a state agency or the University of California under a long-term lease that provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the state’s lease obligation, which are then marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of “indebtedness” within the meaning of the State Constitutional provisions that require voter approval. For purposes of this Appendix A and the tables under “STATE DEBT TABLES,” “lease-purchase obligation” or “lease-purchase financing” means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a state energy efficiency program secured by payments made by various state agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund. See “STATE FINANCES—Sources of Tax Revenue—Special Fund Revenues.” The tables under “STATE DEBT TABLES” do not include equipment leases or leases which were not sold, directly or indirectly, to the public capital markets. The state had \$7,785,005,075 General Fund-supported lease-purchase obligations outstanding as of July 1, 2006. The State Public Works Board, which is authorized to sell lease revenue bonds, had \$3,125,728,040 authorized and unissued as of July 1, 2006. In addition, as of that date, certain joint powers authorities were authorized to issue approximately \$81,000,000 of revenue bonds to be secured by state leases.

### Non-Recourse Debt

Certain state agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from state revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. State agencies and authorities had \$48,272,400,556 aggregate principal amount of revenue bonds and notes which are non-recourse to the General Fund outstanding as of



June 30, 2006, as further described in the table “State Agency Revenue Bonds and Conduit Financing” under “STATE DEBT TABLES.”

Detailed information regarding the state’s long-term debt appears in the section “STATE DEBT TABLES.”

### **Pension Obligation Bonds**

Pursuant to the California Pension Restructuring Bond Act of 2004, Government Code Section 16940, et seq. (the “Restructuring Bond Act”), the state proposed to issue pension obligation bonds to make future contributions to the California Public Employees’ Retirement System (“CalPERS”). The payment of the debt service on the pension obligation bonds would be payable from the General Fund.

Pursuant to the Restructuring Bond Act, the Pension Obligation Bond Committee authorized the issuance of bonds to pay a portion of the state’s pension obligation for fiscal year 2004-05 or a subsequent fiscal year. The Committee initiated a validation action seeking court determination that the bonds would not be in violation of the Constitutional debt limit because the proceeds of the bonds would be used to pay the state’s employer contribution obligation to CalPERS, which is an “obligation imposed by law.” The validation action was challenged in the court by the Pacific Legal Foundation, and this legal challenge prevented the issuance of any pension obligation bonds in time to pay the pension contribution during either fiscal year 2004-05 or fiscal year 2005-06. After a trial in the Sacramento County Superior Court, the judge ruled on November 15, 2005 that the bonds were not valid. The Committee has filed a notice of appeal. The Administration has not included any pension obligation bonds in the 2006 Budget Act, but if the litigation is successful, such bonds can be issued in the future. See “LITIGATION – Matter Seeking Validation of Pension Obligation Bonds.”

### **Economic Recovery Bonds**

The California Economic Recovery Bond Act (“Proposition 57”) was approved by the voters at the statewide primary election on March 2, 2004. Proposition 57 authorizes the issuance of up to \$15 billion in economic recovery bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. Repayment of the economic recovery bonds is secured by a pledge of revenues from a one-quarter cent increase in the state’s sales and use tax starting July 1, 2004. In addition, as voter-approved general obligation bonds, the economic recovery bonds are secured by the state’s full faith and credit. However, moneys in the General Fund will only be used in the event the dedicated sales and use tax revenue is insufficient to repay the bonds.

The state has issued \$10.896 billion principal amount of economic recovery bonds, resulting in the deposit of net proceeds to the General Fund of approximately \$11.254 billion during the 2003–04 fiscal year (of which, for budgetary purposes, approximately \$9.242 billion was applied to the 2002–03 fiscal year and approximately \$2.012 billion was applied to offset fiscal year 2004–05 General Fund expenditures). The state may issue the remainder of authorized economic recovery bonds at any time in the future, but the 2006 Budget Act assumes no economic recovery bonds will be issued in fiscal year 2006-07.

Three different sources of funds are required to be applied to the early retirement (generally by purchase or redemption) of economic recovery bonds: (i) all proceeds from this quarter cent sales tax in excess of the amounts needed, on a semi-annual basis, to pay debt service and other required costs of the bonds, (ii) all proceeds from the sale of surplus state property, and (iii) fifty percent of each annual deposit, up to \$5 billion in the aggregate, of future deposits in the reserve fund created by the California

Balanced Budget Act (see “THE BUDGET PROCESS – Constraints on the Budget Process – Proposition 58” below). Funds from sources (i) and (ii) above were used for early retirement of approximately \$623 million of bonds during fiscal year 2005-06. The state has announced that as of June 30, 2006, there was approximately \$343 million of excess sales tax revenues which will be used to retire economic recovery bonds in the future. The 2006 Budget Act includes \$472 million which will be transferred from the reserve created under Proposition 58 in September 2006, pursuant to the California Balanced Budget Act, which will also be used to retire economic recovery bonds.

### **Tobacco Settlement Revenue Bonds**

In 1998 the state signed a settlement agreement (the “Master Settlement Agreement” or “MSA”) with the four major cigarette manufacturers. Under the MSA, the cigarette manufacturers agreed to make payments to the state in perpetuity, which payments amount to approximately \$25 billion (subject to adjustments) over the first 25 years. Under a separate Memorandum of Understanding, half of the payments made by the cigarette manufacturers will be paid to the state and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). The specific amount to be received by the state and local governments is subject to adjustment. Details in the MSA allow reduction of the manufacturers’ payments for decreases in cigarette shipment volumes by the settling manufacturers, payments owed to certain “Previously Settled States” and certain types of offsets for disputed payments, among other things. However, settlement payments are adjusted upward each year by at least 3 percent for inflation, compounded annually.

Chapter 414, Statutes of 2002, enacted Government Code Sections 63049 to 63049.5 (the “Tobacco Securitization Law”), which authorized the establishment of a special purpose trust to purchase those assets. The bill also authorized that entity to issue revenue bonds secured by the tobacco settlement revenues received beginning in the 2003–04 fiscal year. An initial sale of 56.57 percent of the state’s tobacco settlement revenues producing \$2.485 billion in proceeds was completed in January 2003 (Series 2003A).

A second sale of the remaining 43.43 percent of the state’s tobacco settlement revenues, which produced \$2.264 billion in proceeds, was completed in September 2003 (“Series 2003B”). Chapter 225, Statutes of 2003, amended the Tobacco Securitization Law to require the Governor to request an appropriation in the annual Budget Act to pay debt service and other related costs of the tobacco settlement revenue bonds secured by the second (and only the second) sale of tobacco settlement revenues when such tobacco settlement revenues are insufficient therefor. The Legislature is not obligated to make any such requested appropriation.

In August, 2005, the Series 2003B Bonds were refinanced (“Series 2005A”), retaining substantially all of the covenants of the original issue, including the covenant regarding the request for a General Fund appropriation in the event tobacco revenues fall short. In return for providing this covenant, the state was paid a credit enhancement fee of \$525 million as part of the refinancing. See “PRIOR FISCAL YEAR’S BUDGETS – 2005 Budget Act – Financial Instruments.” Legislation to authorize the refunding of the Series 2003A Bonds has been passed by legislature and is awaiting signature by the Governor, which is expected. The refunding is expected to yield approximately \$900 million to offset the General Fund cost for the initial years of the litigation settlement related to the 2004-05 suspension of the Proposition 98 guarantee. See “STATE FINANCES – Proposition 98.”

In early 2006, participating tobacco manufacturers (PMs) to the Master Settlement Agreement, asserted that they had lost market share in 2003 to the non-participating manufacturers (NPMs). After analysis by a verification agent, that assertion was confirmed. As such, the participating manufacturers are authorized to withhold up to three times the amount of lost market share until such time as it is proven

that the various states diligently enforced their model statutes that govern the NPMs. As a result, the amount of tobacco revenues received by the state was reduced this year by \$50.9 million. Nevertheless, the amount of tobacco revenues received were still in excess of the required debt service payments. Therefore, it is anticipated that the need to invoke the provisions included in the state's budget for Series 2005A is unlikely and there will be no impact to the General Fund for the 2006-07 fiscal year. Furthermore, the Series 2005A Bonds have reserve funds in excess of one year's debt service payments, which would be used before General Fund moneys. A similar filing has been made by the PMs for the 2004 fiscal year but it is anticipated that, likewise, there will be no impact to the General Fund. The State Attorney General has filed suit against the PMs to compel them to pay given that the state has been enforcing the statutes.

Tobacco settlement revenue bonds are neither general nor legal obligations of the state or any of its political subdivisions and neither the faith and credit nor the taxing power nor any other assets or revenues of the state or of any political subdivision is or shall be pledged to the payment of any such bonds.

### **Cash Flow Borrowings**

As part of its cash management program, the state has regularly issued short-term obligations to meet cash flow needs. The state has issued revenue anticipation notes ("Notes" or "RANs") in 19 of the last 20 fiscal years to partially fund timing differences between receipts and disbursements, as the majority of General Fund revenues are received in the last part of the fiscal year. By law, RANs must mature prior to the end of the fiscal year of issuance. If additional external cash flow borrowings are required, the state has issued revenue anticipation warrants ("RAWs"), which can mature in a subsequent fiscal year. See "STATE FINANCES—State Warrants." RANs and RAWs are both payable from any "Unapplied Money" in the General Fund of the state on their maturity date, subject to the prior application of such money in the General Fund to pay Priority Payments. "Priority Payments" are payments as and when due to: (i) support the public school system and public institutions of higher education (as provided in Section 8 of Article XVI of the Constitution of the State), (ii) pay principal of and interest on general obligation bonds and general obligation commercial paper notes of the state, (iii) provide reimbursement from the General Fund to any special fund or account to the extent such reimbursement is legally required to be made to repay borrowings therefrom pursuant to California Government Code Sections 16310 or 16418; and (iv) pay state employees' wages and benefits, state payments to pension and other state employee benefit trust funds, state Medi-Cal claims, and any amounts determined by a court of competent jurisdiction to be required to be paid with state warrants that can be cashed immediately. See "STATE FINANCES" below.

The following table shows the amount of RANs and RAWs issued in the past five fiscal years. The state plans to issue \$1.5 billion of RANs in October, 2006 in order to maintain adequate reserves to manage the state's cash flow requirements during fiscal year 2006-07. This would be the smallest state RAN borrowing since 2000-01.

**TABLE 1**

**State of California Revenue Anticipation Notes and Warrants Issued  
Fiscal Years 2001-02 to 2006-07**

<b>Fiscal Year</b>	<b>Type</b>	<b>Principal Amount (Billions)</b>	<b>Date of Issue</b>	<b>Maturity Date</b>
2001-02	Notes Series A-C	\$5.70	October 4, 2001	June 28, 2002
	RAWs Series A	1.50	June 24, 2002	October 25, 2002
	RAWs Series B	3.00	June 24, 2002	November 27, 2002
	RAWs Series C	3.00	June 24, 2002	January 30, 2003 <sup>†</sup>
2002-03	Notes Series A and C	6.00	October 16, 2002	June 20, 2003
	Notes Series B and D	3.00	October 16, 2002	June 27, 2003
	Notes Series E – G	3.50	November 6, 2002	June 20, 2003
	RAWs Series A and B	10.965	June 18, 2003	June 16, 2004
2003-04	Notes	3.00	October 28, 2003	June 23, 2004
2004-05	Notes Series A – D	6.00	October 6, 2004	June 30, 2005
2005-06	Notes	3.00	November 10, 2005	June 30, 2006
2006-07	Notes	1.50*	October 3, 2006*	June 29, 2007*

<sup>†</sup> Called by the State Controller and paid on November 27, 2002.

\* Anticipated.

Source: State of California, Office of the State Treasurer.

## STATE FINANCES

### The General Fund

The moneys of the state are segregated into the General Fund and over 900 other funds, including special, bond and trust funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of state moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the state. For additional financial data relating to the General Fund, see the financial statements incorporated in or attached to this APPENDIX A. See “FINANCIAL STATEMENTS.” The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor (including the annual Budget Act), as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

### The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties (“SFEU”) is funded with General Fund revenues and was established to protect the state from unforeseen revenue reductions and/or unanticipated expenditure increases. The State Controller may transfer amounts in the SFEU to the General Fund as necessary to meet cash needs of the General Fund and such transfers are characterized as “loans.” The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the State Controller is required

to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code Section 16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the state's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit." In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes. Under Proposition 58, the state will also have a second budgetary reserve, called the Budget Stabilization Account. See "THE BUDGET PROCESS – Constraints on the Budget Process – Proposition 58 (Balanced Budget Amendments)."

See Table 2 and Table 17 for information concerning the recent balances in the SFEU and projections of the balances for the previous and current fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors, including re-estimates of revenues and expenditures, existing statutory requirements and additional legislation introduced and passed by the Legislature may impact the fiscal year-end balance in the SFEU.

### **Inter-Fund Borrowings**

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," comprised of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions to such special fund as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

As of July 31, 2006, there were no outstanding loans from the SFEU and other internal sources to the General Fund. See "STATE FINANCES—State Warrants" and EXHIBIT 2 – "STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1-31, 2006 (UNAUDITED)."

Any determination of whether a proposed borrowing from one of the special funds is permissible must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The State Attorney General has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation

already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the state.

At the November 1998 election, voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual Budget Act. Since the General Fund may reborrow from the transportation accounts any time after the annual repayment is made, the proposition does not have any adverse impact on the state's cash flow.

In addition to temporary inter-fund borrowings described in this section, budgets enacted in the current and past fiscal years have included other transfers and long-term loans from special funds to the General Fund. In some cases, such loans and transfers have the effect of reducing internal borrowable resources.

The following chart shows internal borrowable resources available for temporary loans to the General Fund on June 30 of each of the fiscal years 2002-03 through 2004-05 and estimates, as of June 30, 2006, for fiscal years 2005-06 and 2006-07. See also EXHIBIT 2 – “STATE CONTROLLER’S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1-31, 2006 (UNAUDITED).”

**TABLE 2**

**Internal Borrowable Resources  
(Cash Basis)  
(Millions)**

	<b>2003<sup>(a)</sup></b>	<b>2004<sup>(b)</sup></b>	<b>2005</b>	<b>2006</b>	<b>2007<sup>(c)</sup></b>
Available Internal Borrowable Resources	\$10,401.5	\$9,951.3	\$10,005.3	\$11,708.9	\$15,224.4
Outstanding Loans					
From Special Fund for Economic Uncertainties and Budget Stabilization Account	-0-	-0-	-0-	-0-	1,029.3
From Special Funds and Accounts	-0-	-0-	-0-	-0-	-0-
Total Outstanding Internal Loans	-0-	-0-	-0-	-0-	1,029.3
Unused Internal Borrowable Resources	\$10,401.5	\$9,951.3	\$10,005.3	\$11,708.9	\$14,195.2

(a) At June 30, 2003, the state also had \$10.965 billion of outstanding external borrowings in the form of revenue anticipation warrants.

(b) Includes the receipt of \$11.254 billion of economic recovery bond proceeds to the General Fund resulting from the issuance of three series of economic recovery bonds.

(c) Department of Finance estimates as of June 30, 2006.

Source: State of California, Department of Finance. Information for the fiscal years ended June 30, 2003 through June 30, 2005, are actual figures.

### **State Warrants**

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by state law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient “Unapplied Money” available to pay a warrant when it is drawn, referred to generally as “registered warrants” and “reimbursement warrants.” “Unapplied Money” consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid subject to the prior application of such money to obligations of the state with a higher priority. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings.” Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from state special funds (to the extent permitted by law). See “STATE FINANCES—The Special Fund for Economic Uncertainties” and “—Inter-Fund Borrowings.”

#### Registered Warrants

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which

such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a “registered warrant” to persons or entities (e.g., suppliers and local governments) otherwise entitled to receive payments from the state. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of five percent per annum or at a higher rate if issued for an unpaid revenue anticipation note or in connection with some form of credit enhancement. Registered warrants may or may not have a fixed maturity date. Registered warrants that have no fixed maturity date, and registered warrants that bear a maturity date but, for lack of Unapplied Moneys, were not paid at maturity, are paid, together with all interest due, when the State Controller, with the approval of the PMIB, determines payment will be made. The State Controller then notifies the State Treasurer, who publishes a notice that the registered warrants in question are payable. The duties of the State Controller and the PMIB are ministerial in nature, and the State Controller and the PMIB may not legally refuse to pay the principal of or interest on any registered warrants on any date Unapplied Moneys are available in the General Fund after all Priority Payments have been made on that date.

#### Reimbursement Warrants

In lieu of issuing individual registered warrants to numerous creditors, state law provides an alternative procedure whereby the Governor, upon request of the State Controller, may authorize utilizing the General Cash Revolving Fund in the State Treasury to borrow from other state special funds to meet payments authorized by law. The State Controller may then issue “reimbursement warrants” in the financial market at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund exists solely to facilitate the issuance of reimbursement warrants. Reimbursement warrants may have a fixed maturity date.

The principal of and interest on reimbursement warrants must be paid by the State Treasurer on their respective maturity dates from any Unapplied Money in the General Fund and available for such payment. In the event that Unapplied Money is not available for payment on the respective maturity dates of reimbursement warrants, and refunding warrants (see “—Refunding Warrants”) have not been sold at such times as necessary to pay such reimbursement warrants, such reimbursement warrants will be paid, together with all interest due thereon (including interest accrued at the original interest rate after the maturity date), at such times as the State Controller, with the approval of the PMIB, may determine.

The state has issued reimbursement warrants on several occasions in order to meet its cash needs when state revenues were reduced because of an economic recession, and the state incurred budget deficits. The state most recently issued reimbursement warrants in June 2002 and in June 2003.

#### Refunding Warrants

If there is not sufficient Unapplied Money in the General Fund to pay maturing reimbursement warrants, the State Controller is authorized under state law, with the written approval of the State Treasurer, to offer and sell a new issue of reimbursement warrants as refunding warrants to refund the prior, maturing reimbursement warrants. Proceeds of such refunding warrants must be used exclusively to repay the maturing warrants. In all other respects, refunding warrants have the same legal status and provisions as reimbursement warrants, as described above.

### **Sources of Tax Revenue**

The following is a summary of the state’s major revenue sources. Further information on state revenues is contained under “CURRENT STATE BUDGET” and “STATE FINANCES—Recent Tax



Receipts.” See Table 4 entitled “Comparative Yield of State Taxes—All Funds, 2001–02 Through 2006–07” for a comparison, by amount received, of the sources of the state’s tax revenue.

All revenue proposals included in the 2006-07 Governor’s Budget were adopted except for the proposal to conform to federal tax treatment of Health Savings Accounts.

Chapter 226, Statutes of 2004, created a personal income tax, corporate tax, and sales and use tax amnesty program for 2002 and prior tax years. Penalties were waived for taxpayers who applied for amnesty during the amnesty period of February 1, 2005 to March 31, 2005. Although taxpayers had to apply within this time frame, taxpayers had until the end of May 2005 to submit their tax returns and pay amounts owed. At the conclusion of amnesty, taxpayers who could have applied for amnesty but did not are subject to higher penalties if found to owe additional amounts for amnesty years. The amnesty program is estimated to result in a net multi-year General Fund revenue gain of \$380 million. See “PRIOR FISCAL YEARS' BUDGETS – 2004 Budget Act – Tax Amnesty Program” below.

Four initiative propositions have been placed on the November 2006 election ballot which would, in each case, increase an existing tax or create a new tax, and dedicate such tax revenue for certain specified purposes. See “THE BUDGET PROCESS – Constraints on the Budget Process – November 2006 Initiative Tax Measures.”

#### Personal Income Tax

The California personal income tax, which accounts for a significant portion of General Fund tax revenues, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions), with rates ranging from 1.0 percent to 9.3 percent. The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax (“AMT”), which is much like the federal AMT. The personal income tax structure is considered to be highly progressive. For example, the Franchise Tax Board indicates that the top 1 percent of taxpayers paid 42.7 percent of the total personal income tax in tax year 2004.

Proposition 63, approved by the voters in the November 2004 election, imposes a 1 percent surcharge on taxpayers with taxable income over \$1 million, beginning with the 2005 tax year. The proceeds of the tax surcharge are required to be used to expand county mental health programs.

Taxes on capital gains realizations and stock options, which are largely linked to stock market performance, can add a significant dimension of volatility to personal income tax receipts. Capital gains and stock option tax receipts have accounted for as much as 24.7 percent and as little as 7.3 percent of General Fund revenues in the last ten years. The 2006-07 May Revision estimates that capital gains and stock option tax receipts will account for 13.2 percent of General Fund revenue in 2005-06 and 13.6 percent of General Fund revenue in 2006-07. See “CURRENT STATE BUDGET—Economic Assumptions.”

#### Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

As of January 1, 2006, the breakdown of the base state and local sales tax rate of 7.25 percent is as follows:

- 5 percent imposed as a state General Fund tax;
- 0.5 percent dedicated to local governments for health and welfare program realignment (Local Revenue Fund);
- 0.5 percent dedicated to local governments for public safety services (Local Public Safety Fund);
- 1 percent local tax imposed under the Uniform Local Sales and Use Tax Law, with 0.25 percent dedicated to county transportation purposes and 0.75 percent for city and county general-purpose use; and
- 0.25 percent deposited into the Fiscal Recovery Fund to repay the state's economic recovery bonds (the "Special Sales Tax").

Existing law provides that 0.25 percent of the basic 5 percent state tax rate may be suspended in any calendar year upon certification by the Director of Finance by November 1 in any year in which both of the following occur: (1) the General Fund reserve (excluding the revenues derived from the 0.25 percent sales and use tax rate) is expected to exceed 3 percent of revenues in that fiscal year (excluding the revenues derived from the 0.25 percent sales and use tax rate) and (2) actual revenues for the period May 1 through September 30 equal or exceed the May Revision forecast. The 0.25 percent rate will be reinstated the following year if the Director of Finance subsequently determines conditions (1) or (2) above are not met for that fiscal year. The Department of Finance estimates that the reserve level will be insufficient to trigger a reduction for calendar year 2007. See "CURRENT STATE BUDGET—Summary of State Revenues and Expenditures" for a projection of the fiscal year 2006-07 General Fund reserve.

Existing law provides that the Special Sales Tax will be collected until the first day of the calendar quarter at least 90 days after the Director of Finance certifies that all economic recovery bonds and related obligations have been paid or retired or provision for their repayment has been made or enough sales taxes have been collected to pay all economic recovery bonds and related obligations to final maturity. At such time the Special Sales Tax will terminate and the city and county portion of taxes under the Uniform Local Sales and Use Tax will be automatically increased by 0.25 percent.

Senate Constitutional Amendment No. 4, approved by the voters as Proposition 1A in the November 2004 election, amended the state Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by restricting the state from lowering the local sales tax rate or changing the allocation of local sales tax revenues without meeting certain conditions. See "STATE FINANCES—Local Governments."

#### Corporation Tax

Corporation tax revenues are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the state.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The AMT is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to \$800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first two years of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

6. Fees paid by Limited Liability Companies, which account for 2.6 percent of revenues and are considered “corporation taxes.” The constitutionality of these fees is currently being challenged in two separate state courts. Potential revenue losses are estimated at \$1.12 billion in 2007-08 and \$400 million annually beginning in 2008-09. See “LITIGATION – Tax Refund Cases.”

On February 23, 2004, the U.S. Supreme Court denied the Franchise Tax Board’s appeal requesting review of the decision in *Farmer Brothers Company v. Franchise Tax Board*, a tax refund case which involved the deductibility of corporate dividends. Potential revenue losses are estimated to total \$400 million over several fiscal years through 2007–08 (some revenue gains are expected in fiscal years after that). The revenue impact from this case is included in state budget projections for fiscal year 2006-07.

An initiative measure to increase the corporation tax is on the November 2006 ballot. See “THE BUDGET PROCESS – Constraints on the Budget Process – Initiative Tax Measures on the November 2006 Ballot.”

### Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits.

### Estate Tax; Other Taxes

The California estate tax is based on the state death tax credit allowed against the federal estate tax. The California estate tax is designed to pick up the maximum credit allowed against the federal estate tax return. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 (the “Economic Growth and Tax Relief Reconciliation Act”) phases out the federal estate tax by 2010. As a consequence, the Economic Growth and Tax Relief Reconciliation Act resulted in the reduction of the state estate tax revenues by 25 percent in calendar year 2002, 50 percent in calendar year 2003, and 75 percent in calendar year 2004, and the elimination of the state estate tax beginning in calendar year 2005. The provisions of this federal act sunset after 2010. At that time, the federal estate tax will be reinstated along with the state’s estate tax, unless future federal legislation is enacted to make the provisions permanent. See Table 4 entitled “Comparative Yield of State Taxes—All Funds, 2001-02 Through 2006-07.”

Other General Fund major taxes and licenses include: Inheritance and Gift Taxes; Cigarette Taxes; Alcoholic Beverage Taxes; Horse Racing License Fees and Trailer Coach License Fees.

### Special Fund Revenues

The California Constitution and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

- Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.
- Charges for special services to specific functions, including such items as business and professional license fees.
- Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 37 percent of all special fund revenues in fiscal year 2004-05. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During fiscal year 2004-05, \$8.2 billion was derived from the ownership or operation of motor vehicles. About \$3.3 billion of this revenue was returned to local governments. The remainder was available for various state programs related to transportation and services to vehicle owners. For a discussion of Proposition 1A, approved by the voters in November 2004, which replaced vehicle license fees with increased property tax revenues, see “STATE FINANCES—Local Governments—Vehicle License Fee.”

### Taxes on Tobacco Products

As a result of Proposition 99, approved by the voters in 1988, and Proposition 10, approved by the voters in 1998, the state imposes an excise tax on cigarettes of 87 cents per pack and the equivalent rates on other tobacco products. Tobacco product excise tax revenues are earmarked as follows:

1. Fifty cents of the per-pack tax on cigarettes and the equivalent rate levied on non-cigarette tobacco products are deposited in the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.
2. Twenty-five cents of the per-pack tax on cigarettes and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs.
3. Ten cents of the per-pack tax is allocated to the state’s General Fund.
4. The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund.

An initiative measure to further increase the tax on tobacco products is on the November 2006 ballot. See “THE BUDGET PROCESS – Constraints on the Budget Process – Initiative Tax Measures on the November 2006 Ballot.”

### Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per \$100 of personal income for the past five years and the current fiscal year.

**TABLE 3**

### Recent Tax Receipts

Fiscal Year	Trend of State Taxes per Capita <sup>(a)</sup>		Taxes per \$100 of Personal Income	
	General Fund	Total	General Fund	Total
2001–02 .....	1,801.21	2,105.46	5.52	6.45
2002–03 .....	1,833.10	2,133.14	5.65	6.58
2003–04 .....	1,951.35	2,268.10	5.93	6.89
2004–05 <sup>(b)</sup> .....	2,193.70	2,568.87	6.34	7.43
2005–06 <sup>(c)</sup> .....	2,434.03	2,843.92	6.70	7.83
2006–07 <sup>(c)</sup> .....	2,467.83	2,906.42	6.48	7.63

<sup>(a)</sup> Data reflect population figures based on the 2000 Census.

<sup>(b)</sup> Preliminary.

<sup>(c)</sup> Estimated.

Source: State of California, Department of Finance.

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The following table displays the actual and estimated revenues by major source for the last five years and the current fiscal year. This table shows taxes that provide revenue both to the General Fund and state special funds.

**TABLE 4**  
**Comparative Yield of State Taxes — All Funds**  
**2001–02 Through 2006–07**  
**(Modified Accrual Basis)**  
**(Thousands)**

<b>Year Ending June 30</b>	<b>Sales and Use<sup>(a)</sup></b>	<b>Personal Income</b>	<b>Corporation</b>	<b>Tobacco</b>	<b>Inheritance, Estate and Gift<sup>(b)</sup></b>	<b>Insurance</b>	<b>Alcoholic Beverages</b>	<b>Horse Racing</b>	<b>Motor Vehicle Fuel<sup>(c)</sup></b>	<b>Motor Vehicle Fees<sup>(d)</sup></b>
2002	26,004,521 <sup>(f)</sup>	33,051,107	5,333,030	1,102,806	890,627	1,595,846	292,627	42,247	3,295,903	3,836,795
2003	27,177,756 <sup>(f)</sup>	32,713,830	6,803,583	1,055,505	647,372	1,879,784	290,564	40,509	3,202,512	3,965,410
2004	28,948,622 <sup>(f)</sup>	36,398,983	7,019,216	1,081,588	397,848	2,114,980	312,826	42,143	3,324,883	4,415,126
2005	32,638,090 <sup>(f)</sup>	42,912,860	8,670,065	1,085,721	213,035	2,232,954	314,251	38,491	3,366,142	4,882,664
2006 <sup>(e)</sup>	31,721,666 <sup>(g)</sup>	50,740,000 <sup>(h)</sup>	10,484,000	1,065,915	0	2,247,000	315,000	38,235	3,397,987	5,090,728
2007 <sup>(e)</sup>	33,523,916 <sup>(g)</sup>	52,140,000 <sup>(h)</sup>	10,507,000	1,096,115	0	2,340,000	316,000	38,985	3,482,636	5,265,113

(a) Numbers include local tax revenue from the 0.5 percent rate increase dedicated to local governments for the state-local health and welfare program realignment program. The 0.5 percent rate is equivalent to about \$2.4 billion to \$2.7 billion per year. The figures also reflect a statutory 0.25 percent reduction that occurred only during calendar year 2001.

(b) The state estate tax is based on the state death tax credit allowed against the federal estate tax. As a result, the federal Economic Growth and Tax Relief Reconciliation Act progressively reduced the state estate tax in calendar years 2002 through 2004 and eliminates it beginning in calendar year 2005.

(c) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(d) Registration and weight fees, motor vehicle license fees and other fees. Represents a reduction of vehicle license fee rate on July 1, 2001 from 1.3 percent of vehicle depreciable value to 0.65 percent. Effective July 1, 2005, the rate was reset at 0.65 percent.

(e) Estimated.

(f) The figures do not include voter approved local revenue, local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Figures do include the 0.5 percent Local Public Safety Fund revenue.

(g) Unlike the figures for fiscal years ending June 30, 2002 through June 30, 2005, these estimated figures do not include the 0.5 percent Local Public Safety Fund revenue. These estimated figures also do not include voter approved local revenue, local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Estimate for fiscal year 2005–06 includes \$1.383 billion and for fiscal year 2006–07 includes \$1.456 billion for a temporary one-quarter cent tax increase to be deposited in the Fiscal Recovery Fund and used for repayment of the economic recovery bonds. See “Sources of Tax Revenue—Sales Tax.”

(h) Includes the revenue estimate for a 1 percent surcharge on taxpayers with taxable income over \$1 million, with the proceeds funding mental health programs pursuant to Proposition 63.

NOTE: This table shows taxes that provide revenue both to the General Fund and state special funds. Also, some revenue sources are dedicated to local governments. This accounts for differences between the information in this table and Table 18.

Source: Fiscal years 2001–02 through 2004–05: State of California, Office of the State Controller.  
Fiscal years 2005–06 and 2006–07: State of California, Department of Finance.

## State Expenditures

The following table summarizes the major categories of state expenditures, including both General Fund and special fund programs.

**TABLE 5**  
**Governmental Cost Funds**  
**(Budgetary Basis)**  
**Schedule of Expenditures by Function and Character**  
**Fiscal Years 2000–01 to 2004–05**  
**(Thousands)**

	2000–01	2001–02	2002–03	2003–04	2004–05
Function					
Legislative, Judicial, Executive					
Legislative	\$ 262,370	\$ 265,312	\$ 276,462	\$ 284,894	\$ 408,426
Judicial <sup>(a)</sup>	1,478,710	1,633,518	2,524,446	2,634,409	2,881,680
Executive	1,352,128	1,371,891	1,283,297	1,329,557	1,362,268
State and Consumer Services	950,192	1,100,942	955,054	946,584	1,025,817
Business, Transportation and Housing					
Business and Housing	601,053	240,237	184,573	235,742	196,209
Transportation	4,417,139	6,052,926	3,712,133	6,077,810	6,819,308
Technology, Trade and Commerce <sup>(b)</sup>	140,833	81,832	50,335	10,262	0
Resources	3,349,003	2,284,269	1,993,957	2,100,200	2,232,498
Environmental Protection	869,539	993,144	762,052	749,988	788,805
Health and Human Services	24,204,531	26,563,743	27,420,865	26,793,410	30,223,891
Correctional Programs	4,952,927	5,242,369	5,614,849	5,246,381	6,769,319
Education					
Education–K through 12	28,720,596	28,078,228	27,611,356	28,696,655	32,118,886
Higher Education	9,655,954	9,945,193	9,951,749	9,487,413	9,985,180
Labor and Workforce Development <sup>(c)</sup>	N/A	N/A	250,616	239,051	319,984
General Government					
General Administration	1,294,587	2,475,564	1,830,280	3,580,718	1,745,492
Debt Service	2,270,649	2,432,942	2,067,815	2,103,756	3,390,653
Tax Relief	4,655,826	3,028,703	4,446,940	3,782,731	665,597
Shared Revenues	4,385,429	5,528,996	2,784,970	2,664,766	1,691,964
Brown vs. US Dept. of Health and Human Services	–	96,000	–	–	–
Other Statewide Expenditures	635,475	476,170	526,863	825,833	(1,128,219)
Expenditure Adjustment for Encumbrances <sup>(d)</sup>	(1,943,208)	(681,856)	2,365,728	363,473	(1,038,273)
Credits for Overhead Services by General Fund	(197,343)	(251,575)	(288,871)	(326,928)	(329,796)
Statewide Indirect Cost Recoveries	(36,610)	(47,862)	(50,313)	(59,081)	(74,581)
Total	<u>\$92,019,780</u>	<u>\$96,910,686</u>	<u>\$96,275,156</u>	<u>\$97,767,624</u>	<u>\$100,055,108</u>
Character					
State Operations	\$24,850,286	\$27,994,343	\$26,241,065	\$28,208,541	\$28,783,825
Local Assistance	66,087,018	67,993,721	69,043,191	68,086,507	70,217,159
Capital Outlay	1,082,476	922,622	990,900	1,472,576	1,054,124
Total	<u>\$92,019,780</u>	<u>\$96,910,686</u>	<u>\$96,275,156</u>	<u>\$97,767,624</u>	<u>\$100,055,108</u>

(a) Included in this amount are the expenditures of the Trial Court Trust Fund. As of July 1, 2002, the Trial Court Trust Fund was reclassified to a Governmental Cost Fund from a Non-Governmental Cost Fund.

(b) As of January 2004, Technology, Trade and Commerce was abolished per Assembly Bill 1757 of 2003, Chapter 229. Funds that were abolished were transferred to the General Fund.

(c) Legislation was enacted effective January 1, 2003 which created a new agency function called the Labor and Workforce Development. Fiscal year 2002–03 figure reflects the expenditure for the entire fiscal year. The following agencies were transferred from General Government to this new function: the Employment Development Department, the California Workforce Investment Board, the Agricultural Labor Relations Board, and the Department of Industrial Relations.

(d) Expenditures for the State Highway Account (Fund 0042) and the Traffic Congestion Relief Fund (Fund 3007) are reported on a modified cash basis. This method of accounting eliminated all of the continuing appropriations in these two funds.

N/A – Not applicable

Source: State of California, Office of the State Controller.

## **State Appropriations Limit**

The state is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the “Appropriations Limit”). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the state from spending “appropriations subject to limitation” in excess of the Appropriations Limit. “Appropriations subject to limitation,” with respect to the state, are authorizations to spend “proceeds of taxes,” which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed “the cost reasonably borne by that entity in providing the regulation, product or service,” but “proceeds of taxes” exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not “proceeds of taxes,” such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The Appropriations Limit in each year is based on the Appropriations Limit for the prior year, adjusted annually for changes in state per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non-tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college (“K-14”) districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate “proceeds of taxes” received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor’s Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the Appropriations Limit for fiscal years 2002-03 through 2006-07.

As of the release of the 2006 Budget Act, the Department of Finance projects the Appropriations Subject to the Limit to be \$58.823 billion and \$56.736 billion in fiscal years 2005-06 and 2006-07, respectively.



**TABLE 6****State Appropriations Limit  
(Millions)**

	<b>Fiscal Years</b>				
	<b>2002–03</b>	<b>2003–04</b>	<b>2004–05</b>	<b>2005–06</b>	<b>2006–07</b>
State Appropriations Limit	\$59,591	\$61,702	\$64,588	\$68,890	\$72,304
Appropriations Subject to Limit	(45,832)	(47,921)	(53,488)	(58,823)*	(56,736)*
Amount (Over)/Under Limit	\$13,759	\$13,781	\$11,100	\$10,067*	\$15,568*

\* Estimated/projected.

Source: State of California, Department of Finance.

**Proposition 98**

On November 8, 1988, the voters of the state approved Proposition 98, a combined initiative constitutional amendment and statute called the “Classroom Instructional Improvement and Accountability Act.” Proposition 98 changed state funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 education a minimum level of funding. Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 education the greater of: (a) in general, a fixed percentage of General Fund revenues (“Test 1”), (b) the amount appropriated to K-14 education in the prior year, adjusted for changes in state per capita personal income and enrollment (“Test 2”), or (c) a third test, which replaces Test 1 and Test 2 in any year that the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in state per capita personal income (“Test 3”).

Legislation adopted prior to the end of the 1988–89 fiscal year implementing Proposition 98 determined the K-14 education’s funding guarantee under Test 1 to be 40.7 percent of General Fund tax revenues, based on 1986-87 appropriations. However, this percentage has since been adjusted to approximately 41.0 percent of 1986-87 appropriations to account for subsequent changes in the allocation of local property taxes, since these changes altered the share of General Fund revenues received by schools. The Proposition 98 guarantee has typically been calculated under Test 2. Under Test 3, however, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus 0.5 percent. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a “credit” (called the “maintenance factor”) to schools and is paid to them in future years when per capita General Fund revenue growth exceeds per capita personal income growth.

The Proposition 98 guarantee is funded from two sources: local property taxes and the General Fund. Any amount not funded by local property taxes is funded by the General Fund. Thus, local property tax collections represent an offset to General Fund costs in a Test 2 or Test 3 year.

Proposition 98 also contains provisions for the transfer of certain state tax revenues in excess of the Article XIII B limit to K-14 education in Test 1 years when additional moneys are available. No such transfers are anticipated during fiscal year 2006-07. See “STATE FINANCES—State Appropriations Limit.”

The 2006 Budget Act reflects General Fund Proposition 98 expenditures in fiscal years 2004-05 through 2006-07, as outlined in the table below. The 2006 Budget Act includes no decreases for

declining growth (-0.26 percent) and provides full funding for COLA (5.92 percent) adjustments in 2006-07, and also reflects the deferral of Proposition 98 expenditures of \$1.283 billion from fiscal year 2004-05 to 2005-06, \$1.303 billion from fiscal year 2005-06 to 2006-07, and \$1.303 billion from fiscal year 2006-07 to 2007-08.

**TABLE 7**

**Proposition 98 Funding  
(\$ in Millions)**

	2004-05		2005-06		2006-07	Change From Revised 2005-06	
	Enacted	Revised	Enacted	Revised	Enacted	Amount	Percent
<b>K-12 Proposition 98</b>							
State General Fund .....	\$30,873	\$30,902	\$33,071	\$34,644	\$37,141	\$2,497	7.2%
Local property tax revenue	11,214	11,266	11,573	11,807	11,973	166	1.4
Subtotals <sup>(a)</sup> .....	\$42,087	\$42,168	\$44,644	\$46,451	\$49,114	\$2,663	5.7%
<b>Other Proposition 98</b>							
State General Fund .....	\$ 3,130	\$ 3,132	\$ 3,520	\$ 3,776	\$ 4,154	\$ 378	10.0%
Local property tax revenue	1,772	1,754	1,804	1,819	1,853	34	1.9
Subtotals <sup>(a)</sup> .....	\$4,902	\$4,886	\$5,324	\$5,595	\$6,007	\$ 412	7.4%
<b>Total Proposition 98</b>							
State General Fund .....	\$34,003	\$34,034	\$36,591	\$38,420	\$41,295	\$2,875	7.5%
Local property tax revenue	12,986	13,020	13,377	13,626	13,827	200	1.5
<b>Totals<sup>(a)</sup> .....</b>	<b>\$46,989</b>	<b>\$47,055</b>	<b>\$49,968</b>	<b>\$52,046</b>	<b>\$55,122</b>	<b>\$3,075</b>	<b>5.9%</b>

<sup>(a)</sup> Totals may not add due to rounding.

Source: State of California, Department of Finance

Proposition 98 permits the Legislature, by a two-thirds vote of both houses (on a bill separate from the Budget Act), and with the Governor's concurrence, to suspend the K-14 education's minimum funding guarantee for a one-year period. The amount of the suspension is added to the maintenance factor, the repayment of which occurs according to a specified State Constitutional formula, and eventually restores Proposition 98 funding to the level that would have been required in the absence of such a suspension. Therefore, suspending the minimum funding guarantee provides ongoing General Fund savings over multiple fiscal years until the maintenance factor is fully repaid.

Legislation related to the 2004 Budget Act suspended the Proposition 98 minimum guarantee. At the time the 2004 Budget Act was enacted, this suspension was estimated to be \$2.004 billion. This suspended amount was added to the existing maintenance factor, which was fully paid in 2005-06. However, subsequent growth in General Fund revenue has increased the estimated 2004-05 Proposition 98 guarantee calculation by an additional \$1.6 billion. This additional funding, along with approximately \$1.3 billion in 2005-06 were the subject of a lawsuit which has recently been settled. The terms agreed upon consist of retiring this approximately \$2.9 billion obligation beginning in 2007-08 with a \$300 million payment and then in annual payments of \$450 million beginning in 2008-09 until the full amount is paid. Legislation is proposed to refinance the Golden State Tobacco Securitization Corporation's Series 2003A Bonds to offset the first \$900 million in settlement payments. After estimated and proposed payments in 2005-06 and 2006-07, the total estimated maintenance factor balance will be \$71 million at the end of fiscal year 2006-07. This maintenance factor balance is required to be restored to the Proposition 98 budget over future years as explained above. See "LITIGATION – Action

Seeking Recalculation of Proposition 98 Minimum Funding Guarantee” for information regarding a lawsuit challenging the calculation of Proposition 98 funding for fiscal years 2004-05 and 2005-06 in light of the suspension of the Proposition 98 minimum guarantee in 2004-05.

Proposition 98 appropriations for fiscal years 1995-96, 1996-97, 2002-03, and 2003-04 are cumulatively estimated to be \$1.4 billion below the amounts required by Proposition 98 for those years because of changes in various Proposition 98 factors applicable to those years. Chapter 216, Statutes of 2004, annually appropriates \$150 million per year beginning in fiscal year 2006-07, to repay these prior year Proposition 98 obligations. However, Chapter 491, Statutes of 2005, appropriated \$16.8 million toward these settle-up obligations during the 2005-06 fiscal year, and explicitly reduced the first Chapter 216 settle-up appropriation, from \$150 million to \$133.2 million for 2006-07. The 2006 Budget Act includes this appropriation along with a \$150 million prepayment of the 2007-08 allocation.

### **Local Governments**

The primary units of local government in California are the counties, which range in population from 1,200 in Alpine County to approximately 10 million in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails, and public safety in unincorporated areas. There are also 478 incorporated cities in California and thousands of special districts formed for education, utilities, and other services. The fiscal condition of local governments has been constrained since Proposition 13, which added Article XIII A to the State Constitution (“Proposition 13”), was approved by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose “special taxes” (those devoted to a specific purpose) without two-thirds voter approval. Proposition 218, another constitutional amendment enacted by initiative in 1996, further limited the ability of local governments to raise taxes, fees, and other exactions. Counties, in particular, have had fewer options to raise revenues than many other local government entities, while they have been required to maintain many services.

In the aftermath of Proposition 13, the state provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including assuming principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature eliminated most of the remaining components of post-Proposition 13 aid to local government entities other than K-12 schools and community colleges by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources, such as sales taxes, and reduced certain mandates for local services funded by cities and counties. See “STATE FINANCES—Sources of Tax Revenue—Sales Tax” for a discussion of the impact of the economic recovery bond issuances on local sales taxes.

The 2004 Budget Act, related legislation and the enactment of Senate Constitutional Amendment No. 4 (described below) dramatically changed the state-local fiscal relationship. These constitutional and statutory changes implemented an agreement negotiated between the Governor and local government officials (the “state-local agreement”) in connection with the 2004 Budget Act. One change relates to the reduction of the vehicle license fee (“VLF”) rate from 2 percent to 0.65 percent of the market value of the vehicle. In order to protect local governments, which have previously received all VLF revenues, the reduction in VLF revenue to cities and counties from this rate change was replaced by an increase in the amount of property tax they receive.

As part of the state-local agreement, Senate Constitutional Amendment No. 4 was enacted by the Legislature and subsequently approved by the voters as Proposition 1A (“Proposition 1A”) at the November 2004 election. Proposition 1A amended the State Constitution to, among other things, reduce the Legislature’s authority over local government revenue sources by placing restrictions on the state’s

access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the state will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe state fiscal hardship, two-thirds of both houses of the Legislature approves the borrowing and the amount borrowed is required to be paid back within three years. The state also will not be able to borrow from local property tax revenues for more than two fiscal years within a period of 10 fiscal years, and only if previous borrowings have been repaid. In addition, the state cannot reduce the local sales tax rate or restrict the authority of the local governments to impose or change the distribution of the statewide local sales tax. Proposition 1A also prohibits the state from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005-06, if the state does not provide funding for the activity that has been determined to be mandated, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate to encompass state action that transfers to cities, counties and special districts financial responsibility for a required program for which the state previously had partial or complete responsibility. The state mandate provisions of Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights. See "THE BUDGET PROCESS—Constraints on the Budget Process—Local Government Finance (Proposition 1A of 2004)."

#### Vehicle License Fee

Prior to enactment of the 2004 Budget Act, vehicle license fees were assessed in the amount of two percent of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. A program to offset (or reduce) a portion of the VLF paid by vehicle owners was established by Chapter 322, Statutes of 1998. Beginning January 1, 1999, a permanent offset of 25 percent of the VLF paid by vehicle owners became operative. Various pieces of legislation increased the amount of the offset in subsequent years to the existing statutory level of 67.5 percent of two percent (resulting in an effective rate of 0.65 percent). This level of offset provided tax relief of \$4.3 billion in fiscal year 2003–04.

In connection with the offset of the VLF, the Legislature authorized appropriations from the state General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged. In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient General Fund moneys would be available for this purpose, and, beginning in October 2003, VLF paid by vehicle owners were restored to the 1998 level. However, the offset suspension was rescinded by Governor Schwarzenegger on November 17, 2003, and offset payments to local governments resumed. Local governments received "backfill" payments totaling \$3.80 billion in fiscal year 2002–03 and \$3.1 billion in fiscal year 2003–04. In addition, the state-local agreement also provided for the repayment by August 2006 of the approximately \$1.2 billion that was not received by local governments from July to October of 2003, which is the time period between the suspension of the offsets and the implementation of higher fees.

Beginning in fiscal year 2004–05, the state-local agreement permanently reduced the VLF rate to 0.65 percent, and eliminated the General Fund offset program. The State Constitution, amended by the voter approval of Proposition 1A in the November 2004 election, codifies the obligation of the state to provide replacement revenues to local governments for revenues lost as a result of the decrease in VLF rate below the current level of 0.65 percent of the market value of the vehicle.

The 2005 Budget Act provided for the early repayment, in fiscal year 2005-06, of the whole \$1.2 billion in VLF backfill payments owed to local governments. This payment took place in August 2005. See “PRIOR FISCAL YEARS’ BUDGETS – 2005 Budget Act.”

### *Trial Courts*

Prior to legislation enacted in 1997, local governments provided the majority of funding for the state’s trial court system. The legislation consolidated the trial court funding at the state level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. The state’s trial court system will receive approximately \$2.4 billion and \$2.6 billion in state resources in fiscal years 2005–06 and 2006–07, respectively, and \$475 million in resources from the counties in each fiscal year.

### *Welfare System*

The entire statewide welfare system was changed in response to the change in federal welfare law enacted in 1996 (see “Welfare System”). Under the CalWORKs (defined below) program, counties are given flexibility to develop their own plans, consistent with state law, to implement the program and to administer many of its elements. Counties are still required to provide “general assistance” aid to certain persons who cannot obtain welfare from other programs.

### **Welfare System**

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104–193, the “Law”) fundamentally reformed the nation’s welfare system. The Law included provisions to: (i) convert Aid to Families with Dependent Children (“AFDC”), an entitlement program, to Temporary Assistance for Needy Families (“TANF”), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including to reduce maximum benefits and impose work requirements. The TANF block grant formula under the Law is operative through September 30, 2010, as further described below.

Chapter 270, Statutes of 1997, embodies California’s response to the federal welfare systems. Effective January 1, 1998, California Work Opportunity and Responsibility to Kids (“CalWORKs”) replaced the former AFDC and Greater Avenues to Independence programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Caseload under CalWORKs is projected to decrease by a modest amount in 2006-07. The revised CalWORKs caseload projections are 478,100 cases in fiscal year 2005-06 and 471,700 cases in fiscal year 2006-07. This still represents a major decline in caseload from the rapid growth of the early 1990s, when caseload peaked at 921,000 cases in fiscal year 1994–95. Since CalWORKs’ inception in January 1998, caseload has declined by over 35 percent.

California will continue to meet, but not exceed, the federally-required \$2.7 billion combined state and county maintenance of effort (“MOE”) requirement in fiscal years 2005-06 and 2006-07. In an effort to keep program expenditures within the TANF Block Grant and TANF MOE amounts and address the Administration’s objective to alleviate the structural deficit between the state’s revenues and expenditures, the 2005 Budget Act suspended the July 2005 and July 2006 CalWORKs grant cost-of-

living adjustments. The 2006 Budget Act also maintains expenditures within available resources while continuing efforts to move people from welfare to work. The 2006 Budget Act reflects savings resulting from continued efforts to fully implement state welfare system measures initiated in 2004-05, an estimated decrease in 2005-06 child care expenditures, and implementation of several initiatives to improve the state's work participation in response to TANF Reauthorization, as further described below..

The federal Deficit Reduction Act of 2005 included legislation that reauthorized and extended the TANF program until September 30, 2010. The reauthorization legislation modifies countable work activities under TANF and applies new federal work participation rates to separate state programs. In addition, because reauthorization legislation effectively eliminates the state's caseload reduction credit, the bulk of the CalWORKs caseload will be subject to the 50 percent work participation rate beginning in federal fiscal year 2007. Considerable improvement in work participation rates must be achieved to avoid federal penalties, which could be more than \$2 billion General Fund over a five-year period. While these penalties likely would not be assessed until after 2006-07, the 2006 Budget Act addresses the need to increase work participation rates through substantive program improvements that will support and engage more recipients in activities that lead to self-sufficiency. Major investments include (1) implementing the Pay for Performance county incentive program, (2) providing funding for counties to implement strategies to improve work participation rates based on local needs assessments, (3) increasing temporary shelter rates to prevent homelessness among CalWORKs recipients, (4) augmenting funding for CalWORKs employment services, child care services, and administrative activities, and (5) increasing the TANF reserve to address future changes or improvements to CalWORKs. A workgroup consisting of key stake holders is evaluating options for future program changes.

The 2006 Budget Act includes total CalWORKs-related expenditures of \$7.1 billion for fiscal year 2006-07, compared to \$6.7 billion for fiscal year 2005-06. Both years include an augmentation of \$191.9 million for employment services to enable recipients to move off of aid and into sustainable employment. The 2006 Budget Act includes a TANF reserve of \$222.1 million in 2006-07, which is available for unanticipated needs in any program for which TANF Block Grant funds are appropriated, including CalWORKs benefits, employment services, county administration, and child care costs. The reserve includes \$40 million to fund incentive payments to counties in 2007-08 for improved program outcomes under the Pay for Performance program, and \$15 million to fund future program changes or improvements to CalWORKs to address increased work participation requirements under federal TANF Reauthorization legislation.

### **Health Programs**

Medi-Cal – Medi-Cal, California's Medicaid program, is a health care entitlement program for low-income individuals and families who receive public assistance or otherwise lack health care coverage. Medi-Cal serves just over one in six Californians. Federal law requires Medi-Cal to provide a set of basic services such as doctor visits, laboratory tests, x-rays, hospital inpatient and outpatient care, and skilled nursing care. Also, federal matching funds are available if states choose to provide any of numerous optional benefits. The federal government pays for half of the cost of providing most Medi-Cal services in California, including optional benefits. A wide range of public and private providers and facilities delivers these services. Providers are reimbursed by the traditional fee-for-service method or by payments from managed care plans. Approximately 3.3 million Medi-Cal beneficiaries (almost half of the people receiving Medi-Cal benefits and services) are currently enrolled in managed care plans.

Medi-Cal expenditures are estimated to be \$33.3 billion (\$12.8 billion from the General Fund), in 2005-06 and \$35.1 billion (\$13.8 billion General Fund) in 2006-07. The \$1.8 billion (\$946 million General Fund) increase in 2006-07 is due primarily to increases in caseload, utilization, and costs for services.

Average monthly caseload in Medi-Cal was estimated to be 6.6 million in 2005-06. Caseload is expected to increase in 2006-07 by approximately 85,200, or 1.29 percent, to 6.7 million eligible people. This overall increase compares to an expected 1.4 percent increase in the state's population over the same period.

The federal Medicare Modernization Act ("MMA") of 2003 established an outpatient prescription drug program, known as Medicare Part D, for approximately 43 million Medicare beneficiaries, including one million Californians eligible for both Medicare and Medi-Cal ("dual eligibles"). Effective January 1, 2006, the federal government no longer provides Medicaid matching funds to the states for drug categories now covered by Medicare. In addition, states no longer get Medicaid or supplemental rebates for drugs covered by Medicare. Although the intent of the MMA is for states to receive 10 percent of the savings for no longer providing drug coverage to dual eligibles, the revised federal formula for this calculation is projected to cost the state \$68.7 million in 2006-07 on an accrual accounting basis, rather than the \$169 million savings, which would reflect a full 10 percent. Due to federal implementation problems, the state is providing interim emergency drug coverage to dual eligibles who have not been able to receive their prescription drugs.

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005, which makes several changes to the federal Medicaid program that will impact Medi-Cal. The most significant fiscal change will require, beginning October 2009, states' managed care quality improvement fees to be assessed on all managed care plans, not just on those serving Medicaid beneficiaries. Without conforming statutory changes, the state would lose approximately \$250 million in annual federal revenues beginning in 2009-10 due to non-compliance because current California law permits the state to only collect managed care quality improvement fees on managed care plans serving Medi-Cal beneficiaries. In addition, the federal Deficit Reduction Act of 2005 requires, as a condition of receiving federal funds, that the Medi-Cal program verify the citizenship of those individuals who declare that they are citizens of the United States. Under this new provision, these individuals are required to show proof of identity and citizenship at the time of application and upon redetermination. This provision does not apply to or otherwise affect people who are applying for Medi-Cal as immigrants. The 2006 Health Trailer Bill (AB 1807) includes changes to California's statutory language to implement this change.

SSI/SSP – The federal Supplemental Security Income ("SSI") program provides a monthly cash benefit to eligible seniors and persons with disabilities who meet the program's income and resource requirements. In California, the SSI payment is augmented with a State Supplementary Payment ("SSP") grant. The 2006 Budget Act includes \$3.6 billion from the General Fund for the SSI/SSP Program. This represents a 4.1 percent increase from the revised 2005-06 funding level. The average monthly caseload in this program is estimated to be 1.2 million recipients in 2006-07, a 2.5 percent increase over the 2005-06 projected level.

The three-month delay of the January 2007 federal SSI cost-of-living-adjustment included in the 2005 Budget Act is rescinded in the 2006 Budget Act at a one-time cost of \$42.3 million. Effective January 1, 2007, the federal SSI payment will increase by an estimated 2.1 percent.

### **Pension Trusts**

The three principal retirement systems in which the state participates are the California Public Employees' Retirement System ("CalPERS"), the California State Teachers' Retirement System ("CalSTRS") and the University of California Retirement System ("UCRS"). The assets and liabilities of the funds administered by these systems, as well as certain other retirement funds administered by the state, are included in the financial statements of the state as fiduciary funds and described in Note 23 to the Audited Annual Financial Statements of the State of California for the year ended June 30, 2005 (the

“Audited Financial Statements”), incorporated by reference in or attached to this APPENDIX A. See “FINANCIAL STATEMENTS.”

### CalPERS

CalPERS administers the Public Employment Retirement Fund (“PERF”), which is a multiple employer defined benefit plan. In addition to the state, employer participants, as of June 30, 2005, included 1,059 school districts and 1,523 other public agencies. As of the same date, PERF had 1,016,982 active and inactive program members and 431,901 benefit recipients. The payroll for state employees covered by PERF for fiscal year 2004-05 was approximately \$12.9 billion.

Employees, except those participating in the non-contributory, second tier plan (and who receive generally lower benefits) contribute to PERF based upon required contribution rates. Approximately 6.5 percent of the employees participate in the second tier plan. As part of a memorandum of understanding with the employee unions, the state agreed to suspend employee contributions for miscellaneous and industrial employees for fiscal years 2002-03 and 2003-04. The impact on the unfunded liability from suspending the employee contribution for two years was \$354.5 million. These contributions will be repaid over the next thirty years through contributions toward the unfunded liability.

Contributions to PERF are determined annually on an actuarial basis. Payments into PERF are made from the employer contributions, including the state, and employee contributions. State contributions are made from the General Fund, Special Funds, and Non-Governmental Cost Funds. The following table shows the state’s contributions to PERF for fiscal years 2001-02 through 2005-06 and its estimated contributions for fiscal year 2006-07. Approximately 55 percent of the state contributions to PERF are made from the General Fund.

**TABLE 8**

**State Contribution To PERF  
Fiscal Years 2001-02 to 2006-07**

<u>Fiscal Year</u>	<u>Amount</u>
2001-02	677,200,000
2002-03	1,190,000,000
2003-04	2,213,000,000
2004-05	2,564,000,000
2005-06	2,429,000,000
2006-07 <sup>(1)</sup>	2,665,000,000

<sup>(1)</sup> Estimated.

Source: State of California, Department of Finance.

Increasing contributions shown in Table 8 are due to several factors, including poor investment returns in the early 2000’s and benefit enhancements enacted in 1999. See Table 9 below. The leveling off of contributions in 2005-06 and later years is due in part to new policies adopted by the CalPERS Board, described below.

Set forth below is a summary of additions and deductions from PERF for the past five fiscal years. These figures reflect activity for all employers, including the state.



**TABLE 9**

**Public Employees' Retirement Fund  
Schedule of Additions and Deductions  
(\$ in millions)\***

	<b>Fiscal Year Ended June 30,</b>				
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Contributions: Employer	\$ 322	\$ 801	\$ 1,925	\$ 4,262	5,774
Contributions: Employee	1,766	2,155	1,888	2,266	3,177
Total Contributions	\$ 2,088	\$ 2,956	\$ 3,813	\$ 6,528	8,951
Net Investment Income/(Losses) (including Appreciation)	(12,256)	(9,704)	5,474	24,266	21,894
Total Additions	(10,160)	(6,744)	9,296	30,801	30,845
Total Deduction (Benefits Paid and Administrative Expenses)	(6,106)	(6,743)	(7,320)	(7,980)	(8,798)
Net Assets as of the Beginning of the Fiscal Year	172,541	156,274	142,787	144,763	167,584
Net Assets as of the End of the Fiscal Year	156,274	142,787	144,763	167,584	189,631
Change in Net Assets	(16,266)	(13,487)	1,975	22,821	22,047

\* Totals may not add up due to adjustments.

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Each employer (including the state) contributes an amount equal to the sum of the normal cost and amortization of the unfunded actuarial accrued liability, if any. Actuarial valuations of the PERF are performed as of June 30 of each year. The most recent valuation, as of June 30, 2005, showed an actuarial accrued unfunded liability allocable to state employees of \$14.8 billion. The actuarial valuation for PERF was based upon an assumed 7.75 percent investment return. The average net rate of return experienced by PERF over the past fifteen years, ten years and five years (in each case through fiscal year 2004-05) has been 9.6 percent, 9.3 percent, and 3.9 percent, respectively.

On April 19, 2005, the Board of Directors of CalPERS adopted a new policy for calculating the actuarial value of assets, spreading market value asset gains and losses over 15 years (rather than 3 years, as had been the practice) and changing the corridor limits for the actuarial value of assets from 90 percent–110 percent of market value to 80 percent–120 percent of market value. In addition, CalPERS will calculate the annual contribution amount with regard to gains and losses as a rolling 30 year amortization of all remaining unamortized gains or losses as opposed to the current 10 percent of such gains and losses. These changes are anticipated to reduce employer rate volatility by 50 percent.

Set forth below is a schedule of funding projections of the PERF with respect to the state's covered payroll. Actuarial information for each year is based upon an actuarial valuation performed as of the end of such fiscal year.

**TABLE 10**  
**Public Employees' Retirement Fund**  
**Schedule of Funding Projections (State only)**  
**(\$ in millions)**

	<b>Fiscal Year Ended June 30,</b>				
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Actuarial Value of Assets	\$66,976	\$62,201	\$62,515	\$67,081	\$71,830
Actuarial Accrued Liabilities (AAL)-entry age	64,567	68,854	74,450	79,800	86,595
Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL)	2,409	(6,653)	(11,935)	(12,719)	(14,765)
Covered Payroll	11,905	12,423	12,628	12,624	13,790
Funded Ratio	103.7%	90.3%	84.0%	84.1%	82.9%

Source: CalPERS State and Schools Actuarial Valuation, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

### CalSTRS

CalSTRS administers the Teacher's Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan ("STRP"). STRP is a cost-sharing, multi employer, defined benefit pension plan that provides retirement, disability and survivor benefits for teachers and certain other employees of the California public school system. The STRP is comprised of three programs: the Defined Benefit Program ("DB Program"), the Defined Benefit Supplement Program ("DBS"), and the Cash Balance Benefit Program. Within the DB Program there is also a Supplemental Benefits Maintenance Account ("SBMA") which provides purchasing power protection for retired members. As of June 30, 2005, the DB Program had approximately 1,200 contributing employers, approximately 574,676 active and inactive program members and 201,241 benefit recipients.

The state's General Fund contributions to the DB Program and the SBMA are established by statute. The contribution rate to the DB Program is currently 2.017 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. This percentage resulted in a \$472 million contribution for fiscal year 2004-05. The contribution rate to the SBMA is currently 2.5 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. This percentage resulted in a \$585 million contribution for fiscal year 2004-05. In 2004, CalSTRS actuaries determined that there was an unfunded liability associated with the 1990 benefit structure and, as a result, the state was required to pay an additional 0.524 percent (\$92 million from the General Fund) in fiscal year 2004-05 and one quarterly payment of \$31 million in fiscal year 2005-06 to the DB Program. The 2004 valuation of CalSTRS found the 1990 benefit structure to be fully funded and the state was not required to make this additional contribution in fiscal year 2005-06. In early 2006, an error in the calculation of teacher's salaries was discovered in CalSTRS' accounting system. As a result, it was determined that the unfunded liability associated with the 1990 benefit structure never existed. After discovering the accounting error, CalSTRS also determined that the state had overpaid the DB Program and the SBMA in fiscal year 2002-03 and underpaid these accounts in fiscal years 2003-04 through 2005-06, resulting in a net underpayment of \$3.1 million. Overall, the accounting error resulted in the state making excess contributions to CalSTRS in the amount of \$119.5 million. For the 2006 Budget Act, this amount is to be recognized as a prepayment of the amounts owing from the state to the Teachers' Retirement Fund in 2006-07, which will correspondingly reduce the remaining amount to be transferred in 2006-07 from the

General Fund. Finally, an actuarial analysis performed in 2005 at the direction of the Department of Finance concluded that the currently required state contributions to the SBMA are more than sufficient to maintain purchasing power at 80 percent. The following table shows the state's contributions to CalSTRS for fiscal years 2001-02 through 2005-06 and its estimated contributions for fiscal year 2006-07.

**TABLE 11**

**State Contribution To CalSTRS  
Fiscal Years 2001-02 to 2006-07**

	<b>DB Program</b>	<b>SBMA</b>
2001-02	\$384,749,000	\$487,025,000
2002-03	430,538,000	544,984,000
2003-04	450,895,000	58,868,000
2004-05	563,867,000	584,925,000
2005-06	499,697,000	581,367,000
2006-07 <sup>(1)</sup>	360,182,000	598,391,000

<sup>(1)</sup> Estimated.

Source: State of California, Department of Finance.

The table above does not reflect the impact of the Superior Court decision requiring the state to pay \$500 million of the contribution deferred in fiscal year 2003-04, to CalSTRS. See "LITIGATION—Challenge Seeking Payment to Teachers' Retirement Board."

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Set forth below is a summary of additions and deductions from the DB Program for the past five fiscal years. These figures reflect activity for all employers, as well as the state's contribution.

**TABLE 12**

**State Teachers' Retirement Defined Benefit Program Fund  
Schedule of Additions and Deductions  
(\$ in millions)\***

	<b>Fiscal Year Ended June 30,</b>				
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Contributions: Employer	\$ 1,884	\$ 1,725	\$ 1,968	\$ 2,047	\$ 2,105
Contributions: Employee	1,843	1,873	2,094	2,210	2,327
Contributions: State	946	916	1,015	549	1,219
Total Contributions	\$ 4,674	\$ 4,514	\$ 5,077	\$ 4,806	\$ 5,650
Net Investment Income/(Losses) (including Appreciation)	(10,232)	(6,297)	3,688	16,607	14,138
Total Additions	(5,558)	(1,789)	8,765	21,412	19,779
Total Deduction (Benefits Paid and Administrative Expenses)	(4,086)	(4,639)	(5,102)	(5,723)	(6,317)
Net Assets as of the Beginning of the Fiscal Year	112,782	103,138	96,709	100,372	116,061
Net Assets as of the End of the Fiscal Year	103,138	96,709	100,372	116,061	129,524
Change in Net Assets	(9,644)	(6,428)	3,663	15,689	13,462

\* Totals may not add up due to adjustments

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Each employer contributes 8.25 percent of payroll, while employees contribute 6 percent of pay. The most recent actuarial valuation, performed as of June 30, 2005 showed an actuarial accrued unfunded liability of \$20.3 billion. The significant reduction in the unfunded liability of almost \$3 billion since last year was largely due to the discovery of the error in CalSTRS' accounting system. The actuarial valuation of the DB Program is based upon an assumed 8 percent investment return. The average net rate of return experienced by the DB Program over the past fifteen years, ten years and five years (in each case through fiscal year 2005-06) was 10.4 percent, 9.5 percent and 7.9 percent, respectively.

Set forth below is a schedule for funding projections for the DB Program for the past five fiscal years. Actuarial information is based upon actuarial valuations performed as of the end of such fiscal year, except information as of June 30, 2002 is based upon actuarial valuation for June 30, 2001.

**TABLE 13**

**State Teachers' Retirement Defined Benefit Program Fund  
Schedule of Funding Projections  
(\$ in millions)**

	<b>Fiscal Year Ended June 30,</b>				
	<b>2001</b>	<b>2002<sup>(1)</sup></b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Actuarial Value of Assets	\$107,654	\$107,654	\$108,667	\$114,094	\$121,882
Actuarial Accrued Liabilities (AAL)-entry age	109,881	109,881	131,777	138,254	142,193
Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL)	(2,227)	(2,227)	(23,110)	(24,160)	(20,311)
Covered Payroll	20,585	20,585	23,867	23,764	23,293
Funded Ratio	98.0%	98.0%	82.5%	82.5%	85.7%

<sup>(1)</sup> Based upon actuarial valuation as of June 30, 2001.

Source: CalSTRS Defined Benefit Program Actuarial Valuation as of June 30, 2001, 2002, 2003, 2004, and 2005.

*UC Regents*

The University of California Retirement System consists of: (i) a retirement plan, which is a single employer defined benefit plan funded with university and employee contributions ("UCRP"); (ii) a voluntary early retirement incentive program, which is a defined benefit plan for employees who take early retirement ("PERS-VERIP"); and (iii) three defined contribution plans. As of June 30, 2005, plan membership totaled 215,016, comprised of 124,642 active members, 47,123 inactive members (includes terminated nonvested employees who are eligible for a refund), and 43,251 retirees and beneficiaries receiving benefits.

The state does not make any contributions to the University of California Retirement System. As of June 30, 2005, employee and employer contributions were not required to UCRP and PERS-VERIP, due to the fully funded status of each plan.

Set forth below is a summary of additions and deductions from the UC Regents Retirement Fund for the past five fiscal years.

**TABLE 14**

**University of California Retirement Plan Fund**  
**Schedule of Additions and Deductions**  
**(\$ in thousands)\***

	<b>Fiscal Year Ended June 30,</b>				
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Contributions: Employer	\$ 517	\$ 118	\$ 811	\$ 5,150	\$737
Contributions: Employee	4,405	2,954	7,060	2,503	1,653
Total Contributions	\$ 4,922	\$ 3,072	\$ 7,871	\$ 7,653	\$2,390
Net Investment Income/(Losses) (including Appreciation)	(2,301,959)	(3,460,714)	1,892,384	4,998,664	3,982,916
Total Additions	(2,297,037)	(3,457,642)	1,900,255	5,006,317	3,985,306
Total Deduction (Benefits Paid and Administrative Expenses)	(903,981)	(970,453)	(1,015,248)	(1,145,469)	(1,315,466)
Net Assets as of the Beginning of the Fiscal Year	42,070,918	38,869,900	34,441,805	35,326,812	39,187,660
Net Assets as of the End of the Fiscal Year	38,869,900	34,441,805	35,326,812	39,187,660	41,857,500
Change in Net Assets	(3,201,018)	(4,428,095)	885,007	3,860,848	2,669,840

\* Totals may not add up due to adjustments

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Set forth below is a schedule for funding projections for the UCRP for the past five fiscal years. Actuarial information is based upon valuation performed as of the end of the fiscal year.

**TABLE 15**

**University of California Retirement Plan Fund**  
**Schedule of Funding Projections**  
**(\$ in millions)**

	<b>Fiscal Year Ended June 30,</b>				
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Actuarial Value of Assets	\$40,554	\$41,649	\$41,429	\$41,293	\$41,085
Actuarial Accrued Liabilities (AAL)-entry age	27,451	30,100	32,955	35,034	37,252
Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL)	13,103	11,549	8,474	6,259	3,833
Covered Payroll	6,539	7,227	7,734	7,835	8,150
Funded Ratio	147.7%	138.4%	125.7%	117.9%	110.3%

Source: University of California Retirement Plan Actuarial Valuation Report as of July 1, 2001, 2002, 2003, 2004 and 2005.

### Post Retirement Benefits

The state also provides post-employment health care and dental benefits to its employees and their spouses and dependents, when applicable, and recognizes these costs on a “pay-as-you-go” basis. Table 16 shows the state’s General Fund budget for post-employment benefits from fiscal years 2002-03 to 2006-07 and does not reflect any future liability for current employees or annuitants. It is anticipated that these costs will continue to grow in the future. As of June 30, 2005, approximately 124,695 retirees were enrolled to receive health benefits and 101,655 to receive dental benefits. The employer contribution for health premiums maintains the average 100/90 percent contribution formula established in the Government Code. Under this formula, the state averages the premiums of the four largest health benefit plans in order to calculate the maximum amount the state will contribute toward the retiree’s health benefits. The state also contributes 90 percent of this average for the health benefits of each of the retiree’s dependents. Employees vest for this benefit after serving ten years with the state. With ten years of service credit, employees are entitled to 50 percent of the state’s full contribution. This rate increases by 5 percent per year and with 20 years of service, the employee is entitled to the full 100/90 formula.

**TABLE 16**

**General Fund Budget for Post-Employment Benefits  
Fiscal Years 2002-03 through 2006-07**

<u>Fiscal Year</u>	<u>Amount</u>
2002-03	\$ 576,620,000
2003-04	660,772,000
2004-05	795,554,000
2005-06	895,197,000
2006-07	1,019,368,000

Source: Budget Acts of 2002-03, 2003-04, 2004-05, 2005-06 and 2006-07

On June 21, 2004, the Governmental Accounting Standard Board released its Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (“Statement No. 45”). Statement No. 45 establishes standards for the measurement, recognition and display of post-employment healthcare as well as other forms of post-employment benefits, such as life insurance, when provided separately from pension plan expenditures and related liabilities in the financial reports of state and local governments. Under Statement No. 45, governments will be required to: (i) measure the cost of benefits, and recognize other post-employment benefits expense, on the accrual basis of accounting in periods that approximate employees’ years of service; (ii) provide information about the actuarial liabilities for promised benefits associated with past services and whether, or to what extent, the future costs of those benefits have been funded; and provide information useful in assessing potential demands on the employer’s future cash flows. Statement 45 reporting requirements are effective for the state in the fiscal year beginning July 1, 2007. The state plans to include the actuarial computation of its liability for post-employment health care benefits in the 2007-08 financial statements.

The 2006 Budget Act included funding which will allow the State Controller’s Office to contract with a private actuarial firm to calculate the state’s liability for these benefits. Such report, when made, may negatively affect the state’s financial reports and impact its credit ratings if the state does not adequately manage the long-term costs for other post employment benefits. In February of 2006, the Legislative Analyst’s Office released a report suggesting that the unfunded liability for these benefits could be tens of billions of dollars, and that the cost to fully amortize the unfunded liability could be several billion dollars annually. The costs suggested by the Legislative Analyst’s Office are not based on

any actuarial projections reflecting data for California, and may or may not be consistent with the results of the proposed actuarial valuation.

## **THE BUDGET PROCESS**

### **General**

The state's fiscal year begins on July 1 and ends on June 30 of the following year. The state's General Fund Budget operates on a legal basis, generally using a modified accrual system of accounting for its General Fund, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under state law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues for the ensuing fiscal year. Following the submission of the Governor's Budget, the Legislature takes up the proposal. As required by the Balanced Budget Amendment ("Proposition 58") and as described below, beginning with fiscal year 2004–05, the Legislature may not pass a budget bill in which General Fund expenditures exceed estimated General Fund revenues and fund balances at the time of the passage and as set forth in the budget bill.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of annual expenditure appropriations is the annual Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. See "THE BUDGET PROCESS—Constraints on the Budget Process" below. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Except as noted in the previous paragraph and in the next sentence, bills containing General Fund appropriations must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing appropriations for K-12 schools or community colleges ("K-14 education") only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation are not required to be in the State Treasury at the time an appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

### **Constraints on the Budget Process**

Over the years, a number of laws and constitutional amendments have been enacted, often through voter initiatives, which have increased the difficulty of raising state taxes, restricted the use of the state's General Fund or special fund revenues, or otherwise limited the Legislature and the Governor's discretion in enacting budgets. Historic examples of provisions that make it more difficult to raise taxes include Proposition 13, passed in 1978, which, among other things, required that any change in state taxes enacted for the purpose of increasing revenues collected pursuant thereto, whether by increased rates or changes in computation, be approved by a two-thirds vote in each house of the Legislature. Examples of provisions restricting the use of General Fund revenues are Proposition 98, passed in 1988, which mandates that a minimum amount of General Fund revenues be spent on local education, and Proposition 10, passed in 1988, which raised taxes on tobacco products and mandated how the additional



revenues would be expended. See “STATE FINANCES—Proposition 98” and “—Sources of Tax Revenue—Taxes on Tobacco Products.”

More recently, a new series of Constitutional amendments sponsored by Governor Schwarzenegger and approved by the voters, have also affected the budget process. These include Proposition 58, approved in 2004, which requires the adoption of a balanced budget and restricts future borrowing to cover budget deficits, and Proposition 1A, approved in 2004, which limits the Legislature’s power over local revenue sources. These recent constitutional amendments and other voter initiatives affecting the budget process are described below. Five measures affecting state taxes or the budget process will appear on the November 2006 election ballot, which are also described below.

#### *Balanced Budget Amendment (Proposition 58)*

Proposition 58, approved by the voters in 2004, requires the state to enact a balanced budget, establish a special reserve in the General Fund and restricts future borrowing to cover fiscal year end deficits. As a result of the provisions requiring the enactment of a balanced budget and restricting borrowing, the state would in some cases have to take more immediate actions to correct budgetary shortfalls. Beginning with the budget for fiscal year 2004–05, Proposition 58 requires the Legislature to pass a balanced budget and provides for mid-year adjustments in the event that the budget falls out of balance and the Governor calls a special session to deal with the shortfall. The balanced budget determination is made by subtracting expenditures from all available resources, including prior-year balances.

If the Governor determines that the state is facing substantial revenue shortfalls or spending increases, the Governor is authorized to declare a fiscal emergency. He or she would then be required to propose legislation to address the emergency, and call the Legislature into special session for that purpose. If the Legislature fails to pass and send to the Governor legislation to address the fiscal emergency within 45 days, the Legislature would be prohibited from: (i) acting on any other bills or (ii) adjourning in joint recess until such legislation is passed.

Proposition 58 also requires that a special reserve (the “Budget Stabilization Account” or “BSA”) be established in the state’s General Fund. Beginning with fiscal year 2006–07, a specified portion of estimated annual General Fund revenues would be transferred by the State Controller into the Budget Stabilization Account no later than September 30 of each fiscal year. These transfers would continue until the balance in the Budget Stabilization Account reaches \$8 billion or 5 percent of the estimated General Fund revenues for that fiscal year, whichever is greater. The annual transfer requirement would be in effect whenever the balance falls below the \$8 billion or 5 percent target. The annual transfers can be suspended or reduced for a fiscal year by an executive order issued by the Governor no later than June 1 of the preceding fiscal year. Proposition 58 also provides that one-half of the annual transfers shall be used to retire Economic Recovery Bonds, until a total of \$5 billion has been used for that purpose. The 2006 Budget Act transfers an estimated \$944 million to the Budget Stabilization Account, of which \$472 million will be used to retire Economic Recovery Bonds.

Proposition 58 also prohibits certain future borrowing to cover fiscal year end deficits. This restriction applies to general obligation bonds, revenue bonds, and certain other forms of long-term borrowing. The restriction does not apply to certain other types of borrowing, such as: (i) short-term borrowing to cover cash shortfalls in the General Fund (including revenue anticipation notes or revenue anticipation warrants currently used by the state), or (ii) inter-fund borrowings.

### Local Government Finance (Proposition 1A of 2004)

As described under “STATE FINANCES—Local Governments” above, Senate Constitutional Amendment No. 4 (also known as “Proposition 1A”), approved by the voters in the November 2004 election, amended the State Constitution to, among other things, reduce the Legislature’s authority over local government revenue sources by placing restrictions on the state’s access to local governments’ property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the state will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe state fiscal hardship and two-thirds of both houses of the Legislature approves the borrowing. The amount borrowed is required to be paid back within three years. The state also will not be able to borrow from local property tax revenues for more than 2 fiscal years within a period of 10 fiscal years. In addition, the state cannot reduce the local sales tax rate or restrict the authority of local governments to impose or change the distribution of the statewide local sales tax.

Proposition 1A also prohibits the state from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005–06, if the state does not provide funding for the mandated activity, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate on local governments to encompass state action that transfers to cities, counties and special districts financial responsibility for a required program for which the state previously had partial or complete responsibility. The state mandate provisions of Proposition 1A do not apply to schools or community colleges nor to mandates relating to employee rights.

Proposition 1A further requires the state to reimburse cities, counties, and special districts for mandated costs incurred prior to the 2004-05 fiscal year over a term of years. Chapter 72, Statutes of 2005 (AB 138) requires the payment of mandated costs incurred prior to 2004-05 to begin in 2006-07 and to be paid over a term of 15 years. Currently the estimated cost for claims for mandated costs incurred prior to the 2004-05 fiscal year is \$1.199 billion. The 2006 Budget Act contains \$169.9 million for reimbursement of mandated local government costs incurred prior to 2004-05.

### After School Education Funding (Proposition 49)

An initiative statute, Proposition 49, called the “After School Education and Safety Program of 2002,” was approved by the voters on November 5, 2002, and requires the state to expand funding for before and after school programs in the state’s public (including charter) elementary, middle and junior high schools. This increase is required in 2006-07, and the 2006 Budget Act includes a \$428.4 million increase for these programs, for a total of \$550 million. The budget allocates \$547.4 million for grants for before and after school programs, and \$2.6 million for administrative costs for the California State Department of Education. The additional funds are added to the Proposition 98 minimum funding guarantee for K-14 education and, in accordance with the initiative, cannot be reduced in future years unless the Proposition 98 guarantee is suspended. See “STATE FINANCES—Proposition 98”.

### Mental Health Services (Proposition 63)

On November 2, 2004 the voters approved Proposition 63, which imposes a 1 percent tax surcharge on taxpayers with annual taxable income of more than \$1 million for purposes of funding and expanding mental health services. In addition, Proposition 63 prohibits the Legislature or the Governor from redirecting funds now used for mental health services to other purposes or from reducing General Fund support for mental health services below the levels provided in fiscal year 2003–04.

*Transportation Financing (Proposition 1A, November 2006 Ballot)*

The Legislature has approved Senate Constitutional Amendment No. 7 (“SCA 7”), to protect Proposition 42 transportation funds from any further suspensions. SCA 7 will appear as Proposition 1A on the November 6, 2006 election ballot. Current provisions of the State Constitution enacted as Proposition 42 in 2002, permit the suspension of the annual transfer of motor vehicle fuel sales tax revenues from the General Fund to the Transportation Investment Fund if the Governor declares that the transfer will result in a “significant negative fiscal impact” on the General Fund and the Legislature agrees with a two-thirds vote of each house. SCA 7 would modify the constitutional provisions in a manner similar to Proposition 1A of 2004, so that if such a suspension occurs, the amount owed by the General Fund must be repaid to the Transportation Investment Fund within three years, and only two such suspensions can be made within any ten-year period. In 2003-04, \$868 million of the scheduled Proposition 42 transfer was suspended, and in 2004-05 the full transfer of \$1.258 billion was suspended. The Proposition 42 transfer was fully funded in 2005-06 at \$1.355 billion. The 2006 Budget Act fully funds the Proposition 42 transfer at \$1.420 billion for 2006-07, and also includes \$1.415 billion (\$1.215 billion General Fund) for advance repayment of a portion of the 2003-04 and 2004-05 suspensions. See “CURRENT STATE BUDGET - 2006 Budget Act”.

*Initiative Tax Measures on the November 2006 Ballot*

Proposition 86 – This measure would increase the excise tax on cigarettes by an additional \$2.60 per pack, effective January 2007. Other tobacco products would also see a proportional increase in excise taxes. Proceeds of the tax would, after transfers to replace lost Proposition 10 revenue, be dedicated to a variety of health related programs.

Proposition 87 – This measure would enact a new severance tax on each barrel of oil produced in the state, with certain exemptions. Proceeds from this tax would be spent on development of alternative energy sources, reduction of use of gasoline and diesel fuel and related purposes as specified. The state agency which would implement this measure would be authorized to spend up to \$4 billion from this tax source over a period of ten years after the agency adopts a strategic plan. The severance tax will end when a total of \$4 billion has been expended and any bonds secured by the tax have been repaid.

Proposition 88 -- This measure would enact a new statewide parcel tax, in addition to all local property and parcel taxes, in the fixed amount of \$50 for each parcel of land in the state (generally meaning each unit of property which currently receives a separate local property tax bill). There would be exemptions for certain property owned by elderly or disabled persons. Proceeds of the tax would, after any necessary transfer to the General Fund to make up the estimated loss of revenue due to higher property tax deductions, be used for specified K-12 education programs.

Proposition 89 -- This measure would increase taxes on corporations and financial institutions in order to provide money to support public funding of election campaigns for state offices. The measure would make corresponding changes to existing law concerning campaign financing. The rate of taxation on corporations would be increased from 8.84 percent to 9.04 percent, and the rate for financial institutions would be increased from 10.84 percent to 11.04 percent.

**PRIOR FISCAL YEARS’ BUDGETS**

**Fiscal Years Prior to 2004-05**

The California economy grew strongly between 1994 and 2000, generally outpacing the nation, and as a result, for the five fiscal years from 1995–96 to 1999–00, the General Fund tax revenues

exceeded the estimates made at the time the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid and to fund new ongoing program initiatives, including education spending above Proposition 98 minimums, tax reductions, aid to local governments and infrastructure expenditures. The state ended the 2000–2001 fiscal year with a budget reserve of \$5.39 billion.

However, during fiscal year 2001–02, the state experienced an unprecedented drop in revenues compared to the prior year. The three largest tax sources generated only \$59.7 billion, a drop of over \$13 billion from fiscal year 2000–01, the vast bulk of which was attributable to reduced personal income taxes from stock option and capital gains activity. During the three fiscal years between 2001–02 and 2003–04, the state encountered severe budgetary difficulties because of reduced revenues and failure to make equivalent reductions in expenditures, resulting in successive budget deficits. The budgets for these years included substantial reliance on one-time measures, internal borrowing, and external borrowing. The state also faced a cash flow crisis during this period which was relieved by the issuance of Revenue Anticipation Warrants in June 2002 and June 2003 and Economic Recovery Bonds in the spring of 2004. Additional information about prior fiscal years' budgets for this period can be obtained from prior official statements of state bonds.

### **2004 Budget Act**

The 2004 Budget Act was adopted by the Legislature on July 29, 2004, along with a number of implementing measures, and signed by the Governor on July 31, 2004. This was the first budget signed by Governor Schwarzenegger following his election to office after a recall of Governor Davis in November 2003. The 2004 Budget Act largely reflected the proposals contained in the May Revision of the 2004–05 Governor's Budget, including the application for budgetary purposes of \$2 billion of proceeds of the economic recovery bonds issued in fiscal year 2003–04 (see "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds").

Under the 2004 Budget Act, General Fund revenues were projected to increase 3.6 percent, from \$74.6 billion in fiscal year 2003–04 (which included approximately \$2.3 billion in additional tobacco securitization bond proceeds) to \$77.3 billion in fiscal year 2004–05. The revenue projections assumed a continuing rebound in California's economy as reflected in several key indicators. Excluding the impact of the economic recovery bonds, General Fund expenditures were estimated to increase by 6.7 percent, from \$75.6 billion in fiscal year 2003–04 to \$80.7 billion in fiscal year 2004–05. The June 30, 2005 reserve was projected to be \$768 million, compared to an estimated June 30, 2004 reserve of \$2.198 billion. Final results for the fiscal year were substantially better than these initial projections; see "Fiscal Year 2005–05 Revised Estimates" below.

In summary, the 2004 Budget Act addressed a projected \$13.9 billion budget shortfall through expenditure cuts (\$4.0 billion or 28.7 percent), cost avoidance (\$4.4 billion or 31.7 percent), fund shifts (\$1.6 billion or 11.2 percent), loans or borrowing (\$2.1 billion or 15.4 percent), and transfers and other revenue (\$1.8 billion or 13.0 percent).

The 2004 Budget Act contained the following major components:

1. Rebasing Proposition 98 Minimum Funding Guarantee—The level of Proposition 98 appropriations was reset at a level approximately \$2 billion less than would otherwise be required for fiscal year 2004–05 pursuant to legislation relating to the 2004 Budget Act. See "STATE FINANCES—Proposition 98." (When revenues for 2004–05 were substantially higher than projected, and the Administration did not revise Proposition 98 expenditures, litigation was filed challenging this action. This litigation was settled as part of the 2006 Budget Act. See "CURRENT STATE BUDGET" below.)

2. Higher Education—A new fee policy for higher education was implemented. In fiscal year 2004–05, fees were increased 14 percent for undergraduates and 20 percent for graduate students (25 percent for CSU graduate students majoring in non-teacher preparation programs). The 2004 Budget Act included \$750 million in various spending reductions for higher education from otherwise mandated levels.

3. Health and Human Services—The 2004 Budget Act included \$992 million in reductions in various social service programs from otherwise mandated levels. Based on updated projections of caseload and cost-per-case, these savings are now estimated to be \$1 billion in fiscal year 2004–05.

4. Pension Reform—The 2004 Budget Act eliminated state contributions to CalPERS on behalf of new state employees for the first two years of employment. In addition, the 2004 Budget Act assumed the issuance of \$929 million pension obligation bonds to cover a portion of the state’s required contributions to CalPERS in fiscal year 2004–05. The pension bonds were not issued in fiscal year 2004–05 due to litigation delays. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Pension Obligation Bonds.”

5. Tax Relief—The 2004 Budget Act reflected the elimination of the VLF offset program beginning in fiscal year 2004–05. See “STATE FINANCES—Local Governments.”

6. Other Revenue Enhancements and Expenditure Reductions—The 2004 Budget Act also included \$1.206 billion in savings from the suspension of the Transportation Investment Fund (Proposition 42) transfer.

Fiscal Year 2004–05 Revised Estimates. Final estimates relating to the 2004–05 fiscal year, as released in the 2006–07 Governor's Budget in January, 2006, show that the state experienced substantially more favorable results than were projected at the time the 2004 Budget Act was signed. As a result of revised estimates for years prior to 2004–05, tax amnesty payments (see below) and improved economic results which generated major increases in tax revenues, the Administration estimates that total prior year resources, plus revenues and transfers for 2004–05, were about \$91.5 billion, more than \$9.1 billion higher than originally estimated. Expenditures increased by about \$1.1 billion. As a result, the fund balance at June 30, 2005 was estimated at about \$9.6 billion, of which \$9.1 billion was in the SFEU, compared to the original 2004 Budget Act estimate of \$768 million in the SFEU.

Tax Amnesty Program - Chapter 226, Statutes of 2004, created a personal income tax, corporate tax, and sales and use tax amnesty program for 2002 and prior years. Penalties were waived for taxpayers who applied for the amnesty during the amnesty period of February 1, 2005 to March 31, 2005. The effect of amnesty on the accounting for General Fund revenues has been distortive since payments for years before the current year are accounted for as a “prior year adjustment” for the current year rather than being carried back to those earlier years. Additionally, since some payments were made in advance of future year payments the revenue estimates in the current year, the budget year, and beyond will be lower even though the payments received are accounted for as “prior year adjustments” to the current year. Moreover, much of the money that came in during the amnesty period was in the form of “protective payments,” amounts submitted to avoid the extra penalty, but that would have otherwise been submitted in future years, or that will prove not to have been due at all, as some taxpayers will win their disputes. These refunds must be accounted for in future years.

For budgetary purposes, revenues from the amnesty program resulted in a carry-over adjustment increasing the beginning General Fund balance for fiscal year 2004–05 by \$3.8 billion. This carry over adjustment was and will be reduced in fiscal year 2004–05 and subsequent fiscal years to account for refunds and the recognition of income over a period of time. The estimates of these adjustments has

varied as more up-to-date information has been received, as reflected in differing estimates shown in the footnotes to Figure 1 on page A-45, and Figure 2 on page A-48. The 2005 Budget Act estimated a net multi-year General Fund revenue gain from the amnesty program at \$380 million, which represented a \$180 million increase from the \$200 million gain assumed at the time of the 2005-06 Governor's Budget. These amounts constituted one-time revenues that the 2005 Budget Act used for one-time purposes.

### **2005 Budget Act**

The 2005 Budget Act was adopted by the Legislature on July 7, 2005, along with a number of implementing measures, and signed by the Governor on July 11, 2005. In approving the budget, the Governor vetoed \$190 million in appropriations (including \$115 million in General Fund appropriations).

Under the 2005 Budget Act, General Fund revenues and transfers were projected to increase 5.7 percent, from \$79.9 billion in fiscal year 2004-05 to \$84.5 billion in fiscal year 2005-06. The revenue projections assumed continued but moderating growth in California's economy as reflected in several key indicators. The 2005 Budget Act contained General Fund appropriations of \$90.0 billion, compared to \$81.7 billion in 2004-05. The difference between revenues and expenditures in fiscal year 2005-06 was funded by using a part of the \$7.5 billion fund balance at June 30, 2005. The June 30, 2006 reserve was projected to be \$1.302 billion, compared to an estimated June 30, 2005 reserve of \$6.857 billion. About \$900 million of this reserve was to be set aside for payment in fiscal year 2006-07 of tax refunds and other adjustments related to the tax amnesty program implemented in early 2005. See "– 2004 Budget Act – Fiscal Year 2004-05 Revised Estimates."

The 2005 Budget Act also included special fund expenditures of \$23.3 billion and bond fund expenditures of \$4.0 billion. The state issued \$3.0 billion of Revenue Anticipation Notes (RANs) to meet the state's short-term cash flow needs for fiscal year 2005-06.

The 2005 Budget Act contained the following major components:

1. Proposition 98 – General Fund expenditures increased by \$2.582 billion, or 7.6 percent, to \$36.6 billion. This reflected increases in the Proposition 98 guaranteed funding level resulting from increases in General Fund revenues in fiscal year 2005-06, adjusted for changes in local revenues. The 2005 Budget Act fully funded enrollment growth and a 4.23 percent cost of living increase. Per pupil spending under Proposition 98 was projected to be \$7,402, compared to \$7,023 in the previous year. The 2005 Budget Act reflected savings of \$3.8 billion in 2004-05, which would be restored to the Proposition 98 budget in future years as General Fund revenue growth exceeds personal income growth. See "STATE FINANCES—Proposition 98."

2. Higher Education – The 2005 Budget Act marked the first year of funding for the Higher Education Compact under this Administration. The Compact was signed in spring 2004 with both UC and CSU to provide funding stability for enrollment growth and basic support over the next six fiscal years. The 2005 Budget Act provided for total Higher Education funding of \$17.8 billion from all revenue sources, including \$10.2 billion General Fund. General Fund support for both the UC and CSU was increased by \$134 million (about 5 percent) compared to 2004-05. The 2005 Budget Act assumed fee increases for undergraduate and graduate students, consistent with the Compact, which were approved by the UC and CSU governing boards.

3. Health and Human Services – The 2005 Budget Act increased General Fund expenditures by \$2.1 billion, or 8.5 percent, to \$27.1 billion for Health and Human Services programs. This increase consisted of higher Medi-Cal expenditures of \$1.3 billion, Department of Developmental Services expenditures of \$152 million, Department of Mental Health expenditures of \$306 million, and

Department of Social Services expenditures of \$55 million, among other things. The 2005 Budget Act reflected the suspension of the July 2005 and July 2006 CalWORKs grant cost-of-living-adjustments (COLAs), yielding General Fund savings of \$136 million in 2005-06 and \$139 million in 2006-07. The 2005 Budget Act further assumed the January 2006 and January 2007 COLAs for SSI/SSP recipients would be suspended for estimated General Fund savings of \$132 million in 2005-06, \$407.5 million in 2006-07, and \$281 million in 2007-08. The 2005 Budget Act also included federal fiscal relief of \$223 million due to progress in implementing a single, statewide automated child support system.

4. Retirement and Employee Compensation – The 2005 Budget Act provided for full funding of the state’s statutory obligations to the State Teachers’ Retirement System (“CalSTRS”). The 2005 Budget Act also reflected an augmentation of \$355 million for salary increases and dental and vision premium increases for certain bargaining units.

5. Vehicle License Fee Gap Loan Repayment – The 2005 Budget Act fully repaid the \$1.2 billion that local governments lost between July and October of 2003, when the Vehicle License Fee offset program was temporarily suspended. The state was not required to repay the gap loan until August of 2006. This payment was made in August 2005.

6. Transportation Funding – The Proposition 42 transfer was fully funded at an estimated \$1.3 billion.

7. Financial Instruments – The 2005 Budget Act reflected the state’s issuance of pension obligation bonds to fund approximately \$525 million of the state’s 2005-06 retirement obligation to the California Public Employees’ Retirement System, but an adverse court ruling prevented issuance of these bonds. See “LITIGATION – Matter Seeking Validation of Pension Obligation Bonds.” The 2005 Budget Act reflected the results of the refinancing of the Golden State Tobacco Securitization Bonds, Series 2003B. In exchange for its continued backing of these bonds, the General Fund received \$525 million in August 2005. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Pension Obligation Bonds” and “– Tobacco Settlement Revenue Bonds.”

The original 2005-06 Governor’s Budget had included a proposal to issue \$464 million of judgment bonds to finance the pending settlement of the *Paterno* lawsuit (dealing with the state’s liability for past flood damages), but subsequent developments led to the removal of this proposal from the budget. The state settled three related lawsuits through stipulated judgments. The largest settlement, in the amount of \$428 million, provided for the state to make annual payments of \$42.8 million per year, plus interest, for ten years; the payments are subject to annual appropriation by the Legislature. The first year’s payment, as well as \$36 million to fully discharge the other two stipulated judgments, was included in the 2005 Budget Act.

8. Taxes – The 2005 Budget Act contained no new taxes.

#### **Fiscal Year 2005-06 revised estimates as of the 2006 Budget Act**

The 2006-07 May Revision projected that the state would end fiscal year 2005-06 with a budgetary reserve of \$8.8 billion, up \$7.5 billion from estimates made at the time of the 2005 Budget Act. The 2006 Budget Act projects that the state will have a budgetary reserve at June 30, 2006 of \$9.0 billion, up \$7.7 billion from the 2005 Budget Act estimate. This change in budgetary reserve is a result of revenue and expenditure changes outlines below, and an increase of \$2.3 billion in revenues attributed to 2004-05. See “PRIOR FISCAL YEARS’ BUDGETS – 2004 Budget Act”. As of the adoption of the 2006 Budget Act, General Fund revenues and transfers for 2005-06 are projected at \$92.7 billion, an

increase of \$8.2 billion compared with 2005 Budget Act estimates. This includes the following significant adjustments since the 2005 Budget Act:

- \$8.196 billion increase in major tax revenues due to the improved economic forecast;
- \$245 million increase due to higher State Lands Royalties and Unclaimed Property revenues;
- \$252 million loss in revenues due to not issuing pension obligation bonds as a result of pending litigation contesting their issuance.

As of the adoption of the 2006 Budget Act, General Fund expenditures for fiscal year 2005-06 are projected at \$92.7 billion, an increase of \$2.7 billion compared with 2005 Budget Act estimates. This includes the following significant changes since the 2005 Budget Act:

- \$1.829 billion increase in Proposition 98 expenditures;
- \$500 million for levee evaluation and flood control system improvements;
- \$273 million loss of expenditure savings due to not issuing pension obligation bonds as a result of pending litigation contesting their issuance;
- \$137 million in additional expenditures for employee compensation;
- \$153 million decrease in the Medi-Cal program.

Set forth below is a chart showing a General Fund Budget Summary for fiscal year 2005-06 as originally projected by the 2005 Budget Act, as subsequently revised by the 2006-07 Governor's Budget, and as further revised by the 2006 Budget Act.

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**FIGURE 1**

**2005–06 General Fund Budget Summary  
(\$ Millions)**

	<b>As of 2005 Budget Act</b>	<b>As of 2006–07 Governor’s Budget</b>	<b>As of 2006 Budget Act</b>
<b>Prior Year Resources Available</b>	\$7,498 <sup>(1)</sup>	\$9,634 <sup>(2)</sup>	\$9,511 <sup>(3)</sup>
Revenues and Transfers	84,471	87,691	92,749
Expenditures	90,026	90,294	92,730
<b>Fund Balance</b>	<b>\$1,943</b>	<b>\$7,031</b>	<b>\$9,530</b>
<i>Reserve for Liquidation of Encumbrances</i>	\$641	\$521	\$521
<i>Special Fund for Economic Uncertainties</i>	\$1,302 <sup>(4)</sup>	\$6,510 <sup>(5)</sup>	\$9,009 <sup>(5)</sup>

- (1) Included a carry-over adjustment of \$2.33 billion from amnesty payments, of which \$1.95 billion would have to be refunded or would reduce revenues in future years, including a \$1.05 billion adjustment in fiscal year 2005-06, and \$900 million in fiscal year 2006-07.
- (2) Included a carry-over adjustment of \$2.94 billion from amnesty payments, of which \$2.56 billion will have to be refunded or will reduce revenues in future years, including a \$840 million adjustment in 2005-06, \$800 million in 2006-07, and \$920 million in 2007-08 or later.
- (3) Includes a carry-over adjustment of \$2.73 billion from amnesty payments, of which \$2.35 billion will have to be refunded or will reduce revenues in future years, including a \$730 million adjustment in 2005-06, \$677 million adjustment in 2006-07 and \$939 million in 2007-08 or later.
- (4) Included \$900 million set aside for refunds/accelerations of amnesty related revenue in 2006-07.
- (5) Included a carryover amount for refunds/acceleration of amnesty related revenue estimated to be \$920 million, which is expected to be refunded over a longer period of time, beginning in 2007-08. See “PRIOR FISCAL YEARS’ BUDGETS – 2004 Budget Act – Tax Amnesty Program”.

**CURRENT STATE BUDGET**

*The discussion below of the 2006 Budget Act and the table under “Summary of State Revenues and Expenditures” is based on estimates and projections of revenues and expenditures for the 2006-07 fiscal year and must not be construed as statements of fact. These estimates and projections are based upon various assumptions, which may be affected by numerous factors, including future economic conditions in the state and the nation, and there can be no assurance that the estimates will be achieved. See “— Revenue and Expenditure Assumptions.”*

**2006 Budget Act**

The 2006 Budget Act was adopted by the Legislature on June 27, 2006, along with a number of implementing measures, and signed by the Governor on June 30, 2006. In approving the budget, the Governor vetoed \$112 million in appropriations (including \$62 million in General Fund appropriations)

Under the 2006 Budget Act, General Fund revenues and transfers are projected to increase 1.2 percent, from \$92.7 billion in fiscal year 2005-06 to \$93.9 billion in fiscal year 2006-07. The 2006 Budget Act contains General Fund appropriations of \$101.3 billion, compared to \$92.7 billion in 2005-06. This includes more than \$4.9 billion, or 4.7 percent of total General Fund resources available, to address the state's debt by establishing a budget reserve of \$2.1 billion and making early debt repayments of \$2.8 billion. The difference between revenues and expenditures in 2006-07 is funded by using a large part of the 2005-06 ending fund balance, as shown in Figure 1 above. The June 30, 2007 reserve is projected to be \$2.1 billion, compared to an estimated June 30, 2006 reserve of \$9.5 billion.

The 2006 Budget Act is substantially similar to the 2006-07 May Revision proposals. Compared to the 2006-07 May Revision, however, it also assumed \$299 million greater revenues for 2005-06 based on higher than expected revenues in May, and \$19 million greater revenues in 2006-07 due to expanded sales tax licensing and collection programs. The 2006 Budget Act contains the following major General Fund components:

1. Repayments and prepayments of prior obligations – The 2006 Budget Act proposes \$2.812 billion of repayments and/or prepayments of prior obligations as follows: (1) \$1.415 billion for advance payment of a portion of the 2003-04 and 2004-05 Proposition 42 suspensions (includes \$200 million pre-payment from a special fund); (2) \$472 million for early retirement of the Economic Recovery Bonds under Proposition 58; (3) \$296 million to repay/prepay non-Proposition 98 mandates; (4) \$347 million to repay/prepay loans from special funds; (5) \$150 million to prepay Proposition 98 Settle-Up (reflected in prior year and does not affect 2006-07 operating deficit); (6) \$100 million to prepay flood control subventions; and (7) \$32 million set aside to pay debt service on general obligation bonds in fiscal year 2007-08.

2. Reduction of the operating deficit – The 2006 Budget Act projects that after adjusting for repayments or prepayments of prior obligations and one-time investments, the net operating deficit is estimated at \$3.3 billion.

3. Proposition 98 – The 2006 Budget Act proposes Proposition 98 General Fund expenditures at \$41.3 billion, which is an increase of \$2.9 billion, or 7.5 percent, compared to the revised 2005-06 estimate. When property taxes are taken into account, the total Proposition 98 guarantee is \$55.1 billion, which is an increase of \$3.1 billion, or 5.9 percent. The 2006 Budget Act continues to propose to spend at the level of the Proposition 98 guarantee assuming that the 2004-05 suspension had only been \$2 billion. It also continues to include \$426 million above this level to implement Proposition 49. Furthermore, to resolve the pending lawsuit regarding Proposition 98 funding, the state has agreed to calculate the Proposition 98 guarantee consistent with the legislative intent language contained in Chapter 213, Statutes of 2004. As a result, the state will pay \$2.9 billion in settle-up funding, comprised of approximately \$1.6 billion and \$1.3 billion to count toward the Proposition 98 guarantees for 2004-05 and 2005-06, respectively (see Proposition 98).

4. K-12 Education – The 2006 Budget Act proposes \$67.1 billion in spending from all funds on K-12 education, an increase of \$2.9 billion from the revised 2005-06 estimate. General Fund expenditures are proposed at \$40.5 billion (includes funds provided for prior year settle-up obligations), an increase of \$2.7 billion, or 7 percent. Total per-pupil expenditures from all fund sources are projected to be \$11,264, an increase of \$516, or 4.8 percent from the revised 2005-06 level.

5. Higher Education – The 2006 Budget Act proposes General Fund expenditures at \$11.4 billion, an increase of \$973 million, or 9.4 percent. The 2006 Budget Act marks the second year of funding for the Higher Education Compact. The Compact was signed in Spring 2004 with both UC and CSU to provide funding stability and preserve educational quality over the following six fiscal years in

exchange for improved accountability in a variety of key student performance measures. The 2006 Budget Act proposes additional funding of \$75 million for UC and \$54.4 million for CSU so that student fees in 2006-07 will remain at current 2005-06 levels.

6. Health and Human Services – The 2006 Budget Act proposes \$29.3 billion General Fund to be spent on Health and Human Services programs, which is an increase of \$2.5 billion, or 8.7 percent, from the revised 2005-06 estimate. This increase is primarily due to caseload, population, and other workload increases as well as a one-time investment of \$214 million (\$180 million General Fund) on health care surge capacity needs.

7. Transportation Funding – The 2006 Budget Act includes \$1.42 billion to fully fund Proposition 42 in 2006-07 and \$1.415 billion, including interest, for advance payment of a portion of the 2003-04 and 2004-05 Proposition 42 suspensions (\$200 million to be repaid from a special fund). The 2005 Budget Act assumed repayment of a portion of outstanding transportation loans with \$1 billion in bond proceeds derived from certain Indian gaming revenues to specified transportation programs. This transportation funding package would have provided \$465 million to the State Highway Account, \$290 million to the Traffic Congestion Relief Program, \$122 million to the Public Transportation Account, and \$122 million to cities and counties. There have been several lawsuits that have prevented the bonds from being sold to date, and the 2006 Budget Act instead repays \$151 million of these loans to the State Highway Account in 2005-06 using cash already received from tribal gaming compacts. Bond proceeds in the amount of \$849 million are now budgeted in 2006-07, which would provide \$314 million to the State Highway Account, and would provide the same level of funding to the Traffic Congestion Relief Program, Public Transportation Account, and cities and counties as was originally proposed. See “LITIGATION – Actions Seeking to Enjoin Implementation of Certain Tribal Gaming Compacts” below.

8. Budget Stabilization Account – The 2006 Budget Act fully funds the transfer of an estimated \$944 million to the Budget Stabilization Account (BSA), pursuant to Proposition 58. Half of this amount, or \$472 million, will remain in the BSA as a reserve. The other half will be further transferred for the purpose of early retirement of Economic Recovery Bonds.

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Budget Summary for Fiscal Year 2006-07

Set forth below is a chart showing a General Fund Budget Summary for fiscal year 2006-07 as originally projected by the 2006-07 Governor's Budget, and as further revised by the 2006 Budget Act.

**FIGURE 2**

**2006-07 General Fund Budget Summary  
(Millions)**

	<b>As of 2006-07 Governor's Budget</b>	<b>As of 2006 Budget Act</b>
<b>Prior Year Resources Available</b>	\$7,031 <sup>(1)</sup>	\$9,530 <sup>(2)</sup>
Revenues and Transfers	91,545	93,882
Expenditures	97,902	101,261
<b>Fund Balance</b>	<b>\$674</b>	<b>\$2,151</b>
<i>Reserve for Liquidation of Encumbrances</i>	\$521	\$521
<i>Special Fund for Economic Uncertainties</i>	\$153	\$1,630
<i>Budget Stabilization Account</i>	\$460	\$472
<b>Total Available Reserve</b>	<b>\$613</b>	<b>\$2,102</b>

(1) Included a carry-over adjustment of \$2.1 billion from amnesty payments, of which \$1.72 billion will have to be refunded or will reduce revenues in future years, including a \$800 million adjustment in 2006-07 and \$920 million in 2007-08 or later.

(2) Includes a carry-over adjustment of \$2 billion from amnesty payments, of which \$1.62 billion will have to be refunded or will reduce revenues in future years, including a \$677 million adjustment in 2006-07 and a \$939 million adjustment in 2007-08 or later.

**Strategic Growth Plan**

In January 2006, the Governor proposed a comprehensive Strategic Growth Plan to build the critical infrastructure that is the foundation of the state's economy. In May, the Legislature approved a \$115.8 billion Strategic Growth Plan package, which includes \$37.3 billion in new general obligation bonds to be placed on the November 2006 ballot, \$50.1 billion in existing funding, and \$28.4 billion in new leveraged funding sources. The package consists of the following components:

1. Education -- \$10.4 billion in new general obligation bonds for K-12 and Higher Education facilities. In addition, local school districts will provide \$4.0 billion as their match for the new funds, and \$3.6 billion in remaining, previously authorized general obligation bonds will be fully apportioned to help the needs of local districts.

2. Transportation -- \$19.9 billion in new general obligation bonds for transportation and air quality projects. Existing sources for transportation projects include \$26.4 billion in state and federal fuel taxes that are being used for capital purposes. Additionally, \$526 million is expected to be available from

tribal gaming revenues and bonds and \$8.6 billion from Proposition 42. The additional funding made available due to reauthorization of federal transit and highway funding law is estimated to make \$10 billion available over the next 10 years. Savings in the CalTrans support budget are expected to general \$375 million over the next decade. New funding sources for transportation projects include \$9 billion from the portion of revenues from new and renewed local sales tax measures that historically has been used for projects on the state system. Additionally, \$3.1 billion in Grant Anticipation Revenue Vehicle (GARVEE) bonding against future federal revenues is available. Lastly, initial estimates are that private funding may provide as much as \$8 billion.

3. Flood Protection -- \$4.1 billion in new general obligation bonds for levee repair and flood control projects. In addition, between new local matching funds and contributions from the federal government, over \$3.5 billion of other funds will be invested into the various projects. Finally, a \$500 million General Fund appropriation made from 2005-06 fiscal year funds (AB 142, Chapter 34, Statutes of 2006), will be used for the repair and improvement of critical levees.

4. Housing -- \$2.9 billion in new general obligation bonds for housing construction and assistance, including homeownership programs, affordable rental housing construction, farm worker housing, and housing for the homeless and foster care youth.

#### **LAO Assessment of the 2006 Budget Act**

The Legislative Analyst's Office released a summary of the 2006 Budget Act in July, 2006, titled "Major Features of the 2006 California Budget," consistent with the brief overview above. In a section titled "Out-Year Implications of the 2006-07 Budget" the LAO stated:

"Based on our current projections of revenues and expenditures under the 2006-07 Budget Act policies, the state would continue to face operating shortfalls in the range of \$4.5 billion to \$5 billion in 2007-08 and 2008-09. The carryover reserve from 2006-07 would be available to offset a portion of the shortfall in 2007-08. We will be updating our fiscal projections in November 2006, when we release our *California Fiscal Outlook*."

Publications from the LAO can be read in full by accessing the LAO's website ([www.lao.ca.gov](http://www.lao.ca.gov)) or by contacting the LAO at (916) 445-4656.

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## Summary of State Revenues and Expenditures

The table below presents the actual revenues, expenditures and changes in fund balance for the General Fund for fiscal years 2002–03, 2003–04, and 2004–05, estimated results for fiscal years 2005–06 and 2006–07.

**TABLE 17**  
**Statement of Revenues, Expenditures,**  
**And Changes in Fund Balance—General Fund**  
**(Budgetary Basis)<sup>(a)</sup>**  
**Fiscal Years 2002–03 Through 2006–07**  
**(Millions)**

	2002–03	2003–04	2004–05	Estimated <sup>(b)</sup> 2005–06 <sup>(c)</sup>	Estimated <sup>(b)</sup> 2006–07 <sup>(c)</sup>
<b>Fund Balance—Beginning of Period .....</b>	\$ (2,109.8)	\$ (7,536.2)	\$ 3,309.4	\$ 9,922.7	\$9,530.1
Restatements					
Prior Year Revenue, Transfer Accrual					
Adjustments <sup>(d)</sup> .....	154.4	2,626.1	3,785.4	(202.6)	--
Prior Year Expenditure, Accrual					
Adjustments .....	374.2	512.7	313.7	(208.5)	--
<b>Fund Balance—Beginning of Period, as</b>					
<b>Restated .....</b>	\$ (1,581.2)	\$ (4,397.4)	\$ 7,408.5	\$ 9,511.6	\$9,530.1
Revenues.....	\$68,545.8	\$74,149.8	\$81,980.0	\$92,774.1	\$94,512.0
Other Financing Sources					
Economic Recovery Bonds <sup>(e)</sup> .....	—	11,254.0	—	—	—
Transfers from Other Funds .....	3,289.5	914.8	359.9	(25.5)	(629.7)
Other Additions .....	143.9	124.9	83.8	—	—
<b>Total Revenues and Other Sources .....</b>	<b>\$71,979.2</b>	<b>\$86,443.5</b>	<b>\$82,423.7</b>	<b>\$92,748.6</b>	<b>\$93,882.3</b>
Expenditures					
State Operations.....	\$18,277.6	\$19,498.2	\$17,966.1 <sup>(f)</sup>	\$21,487.1	\$23,838.0
Local Assistance .....	59,145.3	58,610.8	61,674.4	69,287.2	74,195.7
Capital Outlay.....	141.3	348.7	65.1	1,955.8	2,911.2
Unclassified .....	—	—	—	--	316.1
Other Uses					
Transfer to Other Funds .....	370.0	279.0	203.9	— <sup>(g)</sup>	— <sup>(g)</sup>
<b>Total Expenditures and Other Uses .....</b>	<b>\$ 77,934.2</b>	<b>\$78,736.7</b>	<b>\$79,909.5</b>	<b>\$92,730.1</b>	<b>\$101,261.0</b>
<b>Revenues and Other Sources Over or</b>					
<b>(Under) Expenditures and Other Uses .....</b>	<b>\$ (5,955.0)</b>	<b>\$ 7,706.8</b>	<b>\$2,514.2</b>	<b>\$ 18.5</b>	<b>\$(7,378.7)</b>
Fund Balance					
Reserved for Encumbrances .....	\$ 1,037.4	\$ 641.4	\$ 540.4	\$ 521.3	\$521.3
Reserved for Unencumbered Balances of					
Continuing Appropriations <sup>(h)</sup> .....	996.9	902.1	858.7	423.6	28.8
Unreserved—Undesignated <sup>(i)</sup> .....	(9,570.5)	1,765.9	8,523.6	8,585.2	1,601.3
<b>Fund Balance—End of Period .....</b>	<b>\$ (7,536.2)</b>	<b>\$ 3,309.4</b>	<b>\$9,922.7</b>	<b>\$ 9,530.1</b>	<b>\$2,151.4</b>

Footnotes on following page.

Source: Fiscal years 2002–03 to 2004–05: State of California, Office of the State Controller.  
Fiscal years 2005–06 and 2006–07: State of California, Department of Finance.

- (a) These statements have been prepared on a budgetary basis in accordance with state law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The Supplementary Information contained in the state's Audited Basic Financial Statements for the year ended June 30, 2005, incorporated by reference in this APPENDIX A, contains a description of the differences between the budgetary basis and the GAAP basis of accounting and a reconciliation of the June 30, 2005 fund balance between the two methods. See "FINANCIAL STATEMENTS."
- (b) Estimates are shown net of reimbursements and abatements.
- (c) Estimated as of the 2006 Budget Act, June 30, 2006.
- (d) Figure for fiscal year 2003–04 is higher due to a change in account for prior year revenues collected by the Franchise Tax Board ("FTB") for the Voluntary Compliance Initiative revenue. FTB now recognizes audit findings as prior year revenue collected.
- (e) Reflects the issuance of economic recovery bonds sufficient to provide net proceeds to the General Fund of \$11.254 billion in 2003–04 to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds." \$2.012 billion of this amount is budgeted as an expenditure reduction in fiscal year 2004–05.
- (f) Reflects General Fund payment offsets from moneys deposited in the Deficit Recovery Fund (\$2.012 billion).
- (g) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfers from Other Funds."
- (h) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, see Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2006-07 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement (\$880.7 million in fiscal year 2004-05, \$423.6 million in fiscal year 2005-06, and \$28.8 million in fiscal year 2006-07). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the encumbered balance for continuing appropriations.
- (i) Includes Special Fund for Economic Uncertainties ("SFEU"). The Department of Finance generally includes in its estimates of the SFEU and set aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," and "Unreserved—Undesignated." The Department of Finance estimates a \$9.009 billion SFEU balance on June 30, 2006, and projects a \$1,630 million SFEU balance on June 30, 2007, based upon the 2006 Budget Act enacted June 30, 2006. In addition to the SFEU, as of June 30, 2007, there is projected to be an additional reserve of \$472 million in the Budget Stabilization Account (BSA) available to transfer to the General Fund through statute. The total available reserve, including the BSA, is projected to be \$2.102 billion as of June 30, 2007. The BSA was created pursuant to the California Balanced Budget Act (Proposition 58), enacted in 2004.

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## Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 2006 Budget Act estimates for the 2005-06 and 2006-07 fiscal years.

**TABLE 18**

### Major General Fund Revenue Sources and Expenditures

Source	Revenues (Millions)		
	2005-06 <sup>(a)</sup> Enacted	Fiscal Years 2005-06 <sup>(b)</sup> Revised	2006-07 <sup>(b)</sup> Enacted
Personal Income Tax.....	\$43,230	\$49,555	\$50,885
Sales and Use Tax.....	26,951	27,211	28,114
Corporation Tax.....	8,822	10,484	10,507
Insurance Tax.....	2,300	2,247	2,340
All Other.....	3,168 <sup>(c)</sup>	3,252 <sup>(d)</sup>	2,036 <sup>(e)</sup>
Total Revenues and Transfers	<u>\$84,471</u>	<u>\$92,749</u>	<u>\$93,882</u>

Function	Expenditures (Millions)		
	2005-06 <sup>(a)</sup> Enacted	Fiscal Years 2005-06 <sup>(b)</sup> Revised	2006-07 <sup>(b)</sup> Enacted
K-12 Education.....	\$36,583	\$37,855	\$40,510
Health and Human Services.....	27,115	26,965	29,304
Higher Education.....	10,217	10,395	11,368
Corrections and Rehabilitation.....	7,422	7,838	8,751
Legislative, Judicial and Executive.....	3,057	3,093	3,417
Tax Relief <sup>(f)</sup> .....	675	671	679
Resources.....	1,356	1,885 <sup>(g)</sup>	1,826
State and Consumer Services.....	562	576	576
Business, Transportation and Housing.....	1,702 <sup>(h)</sup>	1,723 <sup>(i)</sup>	3,029 <sup>(j)</sup>
All Other.....	1,337 <sup>(k)</sup>	1,729 <sup>(l)</sup>	1,801 <sup>(m)</sup>
Total Expenditures	<u>\$90,026</u>	<u>\$92,730</u>	<u>\$101,261</u>

Source: State of California, Department of Finance. Figures in this table may differ from the figures in Table 4; see "Note" to Table 4.

(a) 2005 Budget Act, July 11, 2005.

(b) 2006-07 Budget Act, June 30, 2006.

(c) Includes \$252 million from pension obligation bonds.

(d) Includes \$525 million due to the refunding of the tobacco securitization bonds and \$0 from pension obligation bonds.

(e) Includes -\$472 million (budgeted as a revenue reduction) transferred to the Budget Stabilization Account to remain in the rainy day fund.

(f) Reflects the elimination of VLF "backfill" payments to local governments.

(g) Reflects \$500 million for levee evaluation and flood control system improvements.

(h) Reflects \$1.313 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund.

(i) Reflects \$1.355 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund.

Footnotes continue on following page.



- (j) Reflects \$1.420 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund and \$1.215 million partial early repayment of the 2003-04 and 2004-05 Proposition 42 suspensions.
- (k) Reflects reduced expenditures of \$308 million due to the anticipated receipt of pension obligation bond proceeds to cover General Fund contributions to pension funds; reflects a \$1.187 billion payment to fully repay the amount that local governments lost between July and October 2003 when the Vehicle License Fee offset program was temporarily suspended.
- (l) Reflects \$1.187 billion to fully repay the amount that local governments lost between July and October 2003 when the Vehicle License Fee offset program was temporarily suspended; assumes no pension obligation proceeds.
- (m) Reflects \$472 million transfer to the Budget Stabilization Account for early retirement of the Economic Recovery Bonds.

## **Development of Revenue Estimates**

The development of the forecast for the major General Fund revenues begins with a forecast of national economic activity prepared by an independent economic forecasting firm. The Department of Finance's Economic Research Unit, under the direction of the Chief Economist, adjusts the national forecast based on the Department's economic outlook. The national economic forecast is used to develop a forecast of similar indicators for California activity.

After finalizing the forecasts of major national and California economic indicators, revenue estimates are generated using revenue forecasting models developed and maintained by the Department of Finance. With each forecast, adjustments are made for any legislative, judicial, or administrative changes, as well as for recent cash results. The forecast is updated twice a year and released with the Governor's Budget by January 10 and the May Revision by May 14.

## **Economic Assumptions**

The revenue and expenditure assumptions set forth above have been based upon certain estimates of the performance of the California and national economies in calendar years 2006 and 2007. In the 2006–07 May Revision, the Department of Finance projected that both economies will decelerate slightly in calendar years 2006 and 2007 largely because of slowing residential construction and real estate markets and rising interest rates but continue to grow at rates close to long-run average growth.

Both the California economy and the national economy improved in 2005 and the first five months of 2006. National economic output grew by 3.5 percent in 2005—a solid gain coming on top of an even better 4.2 percent increase in 2004. The national economy was not as strong in the second half of 2005 as it was in the first half, however. Hurricane destruction, high energy costs, rising interest rates, and a cooling housing sector sapped some of its vitality, and economic output grew at an annualized rate of only 1.7 percent in the fourth quarter of 2005. The economy rebounded in the first quarter of 2006, but recent monthly data suggest that growth decelerated again in the second quarter. The slowing of economic growth is reflected in average monthly job growth, which so far in 2006 is smaller than the average gain in all of 2005. Smaller increases in construction employment account for about a third of the decline in job gains. Still, job gains remain widespread across major industry sectors, and the national unemployment rate has continued to decline, reaching 4.6 percent in May. The cooling of the nation's housing sector is evident in new and existing home sales, which after reaching record annual highs last summer, have trended downward. In addition, single-family housing starts, after reaching a record annual high in 2005, have fallen by 13 percent since January 2006. Rising energy prices have boosted measures of general inflation in the last two years, but until recently, measures of general inflation that exclude energy prices were quite stable. Now, however, even these measures are showing signs that inflation is picking up—a development that is of concern to the Federal Reserve.

Adjusted for inflation, California economic output grew by 4.4 percent in 2005, the 15<sup>th</sup> best performance of the 50 states. California total personal income increased by 6.3 percent in 2005, down somewhat from 6.6 percent growth in 2004, but slightly better than the average gain in personal income from 1984 to 2004. Wage and salary income expanded by 6.5 percent in 2005, stronger than the 6 percent

gain in 2004. Statewide taxable sales grew by 5.9 percent in 2005, in line with personal income growth but down from the 8.7 percent gain in taxable sales in 2004. Made-in-California merchandise exports expanded by 6.2 percent in 2005 and were 7.3 percent higher than a year earlier in the first quarter of 2006. Increased exports to Mexico, Japan and mainland China accounted for over three-quarters of the total gain in exports. Mainland China was the fourth largest recipient of California merchandise exports in the first quarter.

As in the national economy, high energy costs, rising interest rates, and a cooling housing sector slowed California economic growth in the first five months of 2006. Average monthly job gains fell from 24,000 in all of 2005 to 9,000 in the first five months of 2006. About half of the decline was due to a loss of 11,400 construction jobs, which was in part due to rainy weather. Still, unemployment was low in May at 5.0 percent, down from 5.4 percent a year earlier.

Existing home sales fell for the second straight quarter in the first quarter of 2006, pushing them 18 percent below year-ago sales. At \$549,000, the median price of existing single-family homes sold in the first quarter of 2006 was essentially unchanged from the third quarter of 2005. Residential permits were down 13 percent from a year earlier in the first five months of 2006, with single-family permits off 19 percent but multifamily permits up 6 percent.

The valuation of nonresidential building permits rose by 22 percent in the first five months of 2006, however.

The 2006-07 May Revision projected national output growth will slow somewhat in 2006 and again in 2007. California personal income growth is expected to slow slightly in 2006 and more so in 2007. National housing starts and California housing permits are projected to fall in both years.

The Department of Finance sets out the following estimates for the state's economic performance in calendar years 2006 and 2007, which were used in predicting revenues and expenditures for the 2006-07 May Revision and the 2006 Budget Act. Also shown is the Department of Finance's previous forecast for the same calendar years, which was contained in the 2006-07 Governor's Budget.

**TABLE 19****Estimates of State's Economic Performance**

	<b>For Calendar Year 2006</b>		<b>For Calendar Year 2007</b>	
	<b>2006-07 Governor's Budget<sup>(b)</sup></b>	<b>2006-07 May Revision<sup>(a)</sup></b>	<b>2006-07 Governor's Budget<sup>(b)</sup></b>	<b>2006-07 May Revision<sup>(a)</sup></b>
Non-farm wage and salary employment (000)	14,914	15,029	15,104	15,255
Percent Change	1.3%	1.6%	1.3%	1.5%
Personal income (\$ billions)	\$1,415	\$1,425	\$1,493	\$1,507
Percent Change	5.8%	6.2%	5.5%	5.8%
Housing Permits (Units 000)	197	190	183	175
Consumer Price Index (percent change)	3.6%	3.6%	3.0%	2.9%

(a) 2006-07 May Revision, May 12, 2006.

(b) Fiscal Year 2006-07 Governor's Budget Summary: January 10, 2006.

Source: State of California, Department of Finance.

**FINANCIAL STATEMENTS**

The Audited Basic Financial Statements of the State of California for the Year Ended June 30, 2005 (the "Financial Statements") are available. As of June 30, 2002, the State of California has implemented a new financial reporting model, as required by the Governmental Accounting Standards Board ("GASB") in conformity with accounting principles generally accepted in the United States of America. The GASB sets standards of accounting and financial reporting for state and local governments, which have significantly changed the presentation of the financial statements. The Financial Statements consists of an Independent Auditor's Report, a Management Discussion and Analysis, Basic Financial Statements of the state for the Year Ended June 30, 2005 ("Basic Financial Statements"), and Supplementary Information. Only the Basic Financial Statements have been audited, as described in the Independent Auditor's Report. A description of the new accounting and financial reporting standards is contained in Note 1 of the Basic Financial Statements.

Potential investors may also obtain or review a copy of the Financial Statements from the following sources:

1. By obtaining, from any Nationally Recognized Municipal Securities Information Repository, or any other source, a copy of the State of California's Official Statement dated June 14, 2006 for \$700,000,000 State of California Various Purpose General Obligation Bonds and \$314,135,000 General Obligation Refunding Bonds. The Financial Statements are printed in full in such Official Statement. No part of the June 14, 2006 Official Statement is incorporated into this document except for the Financial Statements.

2. By accessing the internet website of the State Controller ([www.sco.ca.gov](http://www.sco.ca.gov)) and selecting "Publications" and then selecting "State Government Annual Financial Reports," or by contacting the Office of the State Controller at (916) 445-2636.

3. By accessing the internet website of the State Treasurer ([www.treasurer.ca.gov](http://www.treasurer.ca.gov)) and under the heading “Inside the Treasurer’s Office” selecting “Bonds – Public Finance,” and then under the heading “Financial Information,” selecting “Recent Financial Information” or by contacting the Office of the State Treasurer at (800) 900-3873.

The State Controller’s unaudited reports of cash receipts and disbursements for the periods of July 1, 2005 to June 30, 2006, and from July 1-31, 2006, are included as Exhibits 1 and 2 to this APPENDIX A. These reports, and the General Fund Cash Basis Report for the Year Ended June 30, 2006, are available on the State Controller’s website.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller’s Office and the Legislative Analyst’s Office. The State Controller issues a monthly report on cash receipts and disbursements recorded on the State Controller’s records. The Department of Finance issues a monthly bulletin, available by accessing the internet website of the Department of Finance ([www.dof.ca.gov](http://www.dof.ca.gov)), which reports the most recent revenue receipts as reported by state departments, comparing those receipts to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at the time of budget enactment. These bulletins and reports are available on the internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into the Official Statement. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year. Information which may appear in the Official Statement from the Department of Finance concerning monthly receipts of “agency cash” may differ from the State Controller’s reports of cash receipts for the same periods because of timing differences in the recording of in-transit items.

### **INVESTMENT OF STATE FUNDS**

Moneys on deposit in the State’s Centralized Treasury System are invested by the State Treasurer in the Pooled Money Investment Account (“PMIA”). As of July 31, 2006, the PMIA held approximately \$43.6 billion of state moneys, and \$15.9 billion invested for about 2,628 local governmental entities through the Local Agency Investment Fund (“LAIF”). The assets of the PMIA as of July 31, 2006, are shown in the following table:

**TABLE 20****Analysis of the Pooled Money Investment Account Portfolio\***

<b>Type of Security</b>	<b>Amount (Thousands)</b>	<b>Percent of Total</b>
U.S. Treasury	\$2,665,010	4.5%
Commercial Paper	7,589,068	12.8
Certificates of Deposits	12,787,406	21.5
Corporate Bonds	923,045	1.6
Federal Agency	18,403,873	30.9
Bankers Acceptances	--	0.0
Bank Notes	1,150,039	1.9
Loans Per Government Code	8,248,847	13.9
Time Deposits	8,000,495	13.4
Repurchases	--	0.0
Reverse Repurchases	(248,065)	-0.4
	<u>\$59,519,718</u>	<u>100.0%</u>

\* Totals may differ due to rounding.

Source: State of California, Office of the State Treasurer.

The state's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB. The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The State Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of July 31, 2006 was 164 days.

## **OVERVIEW OF STATE GOVERNMENT**

### **Organization of State Government**

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the state voters may directly influence state government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on state finances, among other subjects. The Bureau of State Audits, headed by the State Auditor,

an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles. See "FINANCIAL STATEMENTS."

The Governor is the chief executive officer of the state and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, state law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

<b><u>Office</u></b>	<b><u>Name</u></b>	<b><u>Party Affiliation</u></b>	<b><u>First Elected</u></b>
Governor	Arnold Schwarzenegger	Republican	2003
Lieutenant Governor	Cruz Bustamante	Democrat	1998
Controller	Steve Westly	Democrat	2002
Treasurer	Philip Angelides	Democrat	1998
Attorney General	Bill Lockyer	Democrat	1998
Secretary of State	Bruce McPherson <sup>(a)</sup>	Republican	-
Superintendent of Public Instruction	Jack O'Connell	Democrat	2002
Insurance Commissioner	John Garamendi	Democrat	2002

(a) Confirmed by the Legislature and sworn in as Secretary of State on March 30, 2005.

The current term for each office expires in January 2007. Persons elected to statewide offices are limited to two terms in office (eight years) from the dates shown above. Mr. Garamendi previously served as elected Insurance Commissioner before term limits were enacted. Governor Schwarzenegger is seeking re-election in 2006 to one more term.

The executive branch is principally administered through eleven major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Labor and Workforce Development Agency, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs and a new Department of Corrections and Rehabilitation, which took over the functions of the Youth and Adult Correctional Agency as of July 1, 2005. In addition, some state programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over certain functions of state government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three segments: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 54,500 degrees were awarded in the 2004-05 school year. Approximately 206,700 full-time students were enrolled at the ten UC campuses and the Hastings College of Law in the 2005-06 school year. (The newest campus, at Merced, opened to graduate students in 2004, and to undergraduates in the fall of 2005.) The California State University System provides undergraduate and graduate degrees to students. Approximately 84,000 degrees were awarded in the 2004-05 school year. About 332,200 full-time students were enrolled at the 23 campuses in the 2005-06 school year. The third sector consists of 109 campuses operated by 72 community college districts, which provide associate degrees and

certificates to students. Additionally students may attend community colleges to meet basic skills and other general education requirements prior to transferring to a four-year undergraduate institution. More than 99,000 associate degrees and certificates were awarded in the 2004-05 school year. Over 1.6 million students were enrolled in California's community colleges in the spring of 2005.

### **Employee Relations**

In 2005–06, the state work force is comprised of approximately 334,000 positions, of which approximately 116,000 positions represent employees of institutions of higher education. Of the remaining 218,000 positions, approximately 182,000 are subject to collective bargaining and approximately 36,000 are excluded from collective bargaining. State law provides that state employees, defined as any civil service employee of the state and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

There are twenty-one collective bargaining units that represent state employees. Eighteen bargaining unit contracts have expired, one expires in July 2007, and two expire in June and July of 2008. Of the twenty-one bargaining units, twenty have negotiated new contracts, which are pending ratification by bargaining unit members and the Legislature. For the units that do not have a signed contract, the terms of the prior agreements remain in effect. The Department of Personnel Administration is continuing to negotiate with these units. The state has not experienced a major work stoppage since 1972. The California State Employees' Association is the exclusive representative for nine of the twenty-one collective bargaining units, or approximately 50 percent of those represented employees subject to collective bargaining. Their contracts are pending ratification. Each of the remaining exclusive representatives represents only one bargaining unit.

## **ECONOMY AND POPULATION**

### **Introduction**

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. In early 2001, California's economy slipped into a recession, which was concentrated in the state's high-tech sector and, geographically, in the San Francisco Bay Area. The economy has since recovered with 604,800 jobs gained between July 2003 and May 2006 compared with 367,600 jobs lost between January 2001 and July 2003. See "CURRENT STATE BUDGET—Economic Assumptions."

## **Population and Labor Force**

The state's July 1, 2005 population of about 37 million represented over 12 percent of the total United States population. California is by far the most populous state in the nation, almost two-thirds larger than the second-ranked state according to the 2000 U.S. Census. California has grown about twice as rapidly as the national population during the last half of the 20th century, averaging about 26% growth for each decade between 1950 and 2000. Although California's growth slowed during the 1990s, and is not expected to match the levels of the earlier decades before 1990, it is still expected to be in the range of 1 to 1.5% annually through at least the end of this decade. Population growth is expected to be about equally due to natural increase (excess of births over deaths) and net migration into the state.

Population growth in the next five years is expected to be largest in the over age 65 category, with above statewide average growth in the working age and college age categories. School age and preschool categories will have lower than statewide average growth, reflecting lower births in the state during the 1990s when the current and near future school age population was born.

California's population is perhaps the most diverse in the nation. As of the 2000 Census, no single ethnic group constituted a majority of the population. It is estimated that within the next 10-15 years, the Latino population will be the largest ethnic group in the state.

California's population is concentrated in metropolitan areas. As of the April 1, 2000 census, 97 percent resided in the 25 Metropolitan Statistical Areas in the state. As of July 1, 2004, the 5-county Los Angeles area accounted for 49 percent of the state's population, with over 17.0 million residents, and the 11-county San Francisco Bay Area represented 20 percent, with a population of over 7.0 million.

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The following table shows California's population data for 1995 through 2005.

**TABLE 21**

**Population 1995-2005<sup>(a)</sup>**

<b>Year</b>	<b>California Population</b>	<b>% Increase Over Preceding Year</b>	<b>United States Population</b>	<b>% Increase Over Preceding Year</b>	<b>California as % of United States</b>
1995	31,712,000	0.6%	266,278,393	1.2%	11.9%
1996	31,963,000	0.8	269,394,284	1.2	11.9
1997	32,453,000	1.5	272,646,925	1.2	11.9
1998	32,863,000	1.3	275,854,104	1.2	11.9
1999	33,419,000	1.7	279,040,168	1.2	12.0
2000	34,099,000	2.0	282,193,477	1.1	12.1
2001	34,784,000	2.0	285,107,923	1.0	12.2
2002	35,393,000	1.7	287,984,799	1.0	12.3
2003	35,990,000	1.7	290,850,005	1.0	12.4
2004	36,506,000	1.4	293,656,842	1.0	12.4
2005	37,005,000	1.4	296,410,404	0.9	12.5

(a) Population as of July 1.

Source: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

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The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1995 to 2005.

**TABLE 22**  
**Labor Force 1995-2005**  
**(Thousands)**

<b>Year</b>	<b>Labor Force</b>	<b>Employment</b>	<b>Unemployment Rate (%)</b>	
			<b>California</b>	<b>United States</b>
1995	15,264	14,062	7.9%	5.6%
1996	15,436	14,304	7.3	5.4
1997	15,793	14,792	6.4	4.9
1998	16,167	15,204	6.0	4.5
1999	16,431	15,567	5.3	4.2
2000	16,858	16,024	4.9	4.0
2001	17,152	16,220	5.4	4.7
2002	17,331	16,168	6.7	5.8
2003	17,404	16,213	6.7	6.0
2004	17,655	16,576	6.2	5.5
2005	17,696	16,747	5.4	5.1

Source: State of California, Employment Development Department.

### **Employment, Income, Construction and Export Growth**

The following table shows California's non-agricultural employment distribution and growth for 1995 and 2005.

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**TABLE 23****Payroll Employment By Major Sector  
1995 and 2005**

<b>Industry Sector</b>	<b>Employment (Thousands)</b>		<b>% Distribution of Employment</b>	
	<b>1995</b>	<b>2005</b>	<b>1995</b>	<b>2005</b>
Trade, Transportation and Utilities	2,398.2	2,814.4	19.3%	19.0%
Government				
Federal Government	311.9	249.1	2.5	1.7
State and Local Government	1,795.1	2,164.8	14.5	14.6
Professional and Business Services	1,667.8	2,147.7	13.4	14.5
Educational and Health Services	1,238.9	1,584.5	10.0	10.7
Manufacturing				
Nondurable goods	635.3	544.8	5.1	3.7
High Technology	488.6	394.9	3.9	2.7
Other Durable Goods	590.9	473.0	4.8	3.9
Leisure and Hospitality	1,181.5	1,474.4	9.5	10.0
Financial Activities	742.3	926.8	6.0	6.3
Construction	498.8	901.8	4.0	6.1
Other Services	430.6	510.7	3.5	3.5
Information	415.9	475.0	3.3	3.2
Natural Resources and Mining	26.1	23.3	0.2	0.2
<b>TOTAL NON-AGRICULTURAL</b>	<b>12,422.0</b>	<b>14,785.2</b>	<b>100%</b>	<b>100%</b>

Source: State of California, Employment Development Department.

The following tables show California's total and per capita income patterns for selected years.

**TABLE 24****Total Personal Income in California 1995-2005<sup>(a)</sup>**

<b>Year</b>	<b>Millions</b>	<b>% Change<sup>(b)</sup></b>	<b>California % of U.S.</b>
1995	\$ 765,806	4.8%	12.4%
1996	810,448	5.8	12.3
1997	860,545	6.2	12.4
1998	936,009	8.8	12.5
1999	999,228	6.8	12.7
2000	1,103,842	10.5	13.0
2001	1,135,304	2.9	12.9
2002	1,147,716	1.1	12.8
2003	1,184,265	3.2	12.8
2004	1,262,306	6.6	12.9
2005	1,338,181	6.0	13.0

(a) Bureau of Economic Analysis ("BEA") estimates as of March 28, 2006.

(b) Change from prior year.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA.

**TABLE 25****Per Capita Personal Income 1995-2005<sup>(a)</sup>**

<b>Year</b>	<b>California</b>	<b>% Change<sup>(b)</sup></b>	<b>United States</b>	<b>% Change<sup>(b)</sup></b>	<b>California % of U.S.</b>
1995	\$24,161	4.1%	\$23,076	4.1%	104.7%
1996	25,312	4.8	24,175	4.8	104.7
1997	26,490	4.7	25,334	4.8	104.6
1998	28,374	7.1	26,883	6.1	105.5
1999	29,828	5.1	27,939	3.9	106.8
2000	32,463	8.8	29,845	6.8	108.8
2001	32,882	1.3	30,574	2.4	107.5
2002	32,803	-0.2	30,810	0.8	106.5
2003	33,400	1.8	31,484	2.2	106.1
2004	35,219	5.4	33,050	5.0	106.6
2005	37,036	5.2	34,586	4.6	107.1

(a) BEA's estimates as of March 28, 2006.

(b) Change from prior year.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA.

The following tables show California's residential and non-residential construction.

**TABLE 26****Residential Construction Authorized by Permits**

<b>Year</b>	<b>Units</b>			<b>Valuation<sup>(a)</sup> (millions)</b>
	<b>Total</b>	<b>Single</b>	<b>Multiple</b>	
1995	85,293	68,689	16,604	\$13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976
1999	140,137	101,711	38,426	25,783
2000	148,540	105,595	42,945	28,142
2001	148,757	106,902	41,855	28,804
2002	167,761	123,865	43,896	33,305
2003	195,682	138,762	56,920	38,968
2004	212,960	151,417	61,543	44,777
2005	208,972	155,322	53,650	47,138

(a) Valuation includes additions and alterations.

Source: Construction Industry Research Board

**TABLE 27**  
**Nonresidential Construction**  
**(Thousands)**

<b>Year</b>	<b>Commercial</b>	<b>Industrial</b>	<b>Other</b>	<b>Additions and Alterations</b>	<b>Total</b>
1995	\$2,308,911	\$ 732,874	\$1,050,693	\$4,062,273	\$ 8,154,751
1996	2,751,925	1,140,574	1,152,443	4,539,219	9,584,161
1997	4,271,378	1,598,428	1,378,220	5,021,792	12,269,818
1998	5,419,251	2,466,530	1,782,337	5,307,901	14,976,019
1999	5,706,719	2,256,166	2,350,213	6,269,194	16,582,292
2000	6,962,031	2,206,169	2,204,754	7,252,004	18,624,958
2001	6,195,368	1,552,047	2,584,321	6,421,551	16,753,287
2002	5,195,348	1,227,754	2,712,681	5,393,329	14,529,112
2003	4,039,561	1,320,222	2,954,039	5,601,117	13,914,939
2004	5,105,541	1,456,283	3,100,982	6,026,567	15,689,373
2005	5,853,351	1,693,373	3,818,100	6,900,709	18,265,533

Source: Construction Industry Research Board

The following table shows changes in California's exports for the period from 1996 through 2005.

**TABLE 28**  
**Exports Through California Ports**  
**(Millions)**

<b>Year</b>	<b>Exports<sup>(a)</sup></b>	<b>% Change<sup>(b)</sup></b>
1996	\$124,120.0	6.2%
1997	131,142.7	5.7
1998	116,282.4	-11.3
1999	122,092.8	5.0
2000	148,554.6	21.7
2001	127,255.3	-14.3
2002	111,340.1	-12.5
2003	113,550.7	2.0
2004	123,039.2	8.4
2005	129,988.9	5.6

(a) "Free along ship" Value Basis.

(b) Change from prior year.

Source: U.S. Department of Commerce, Bureau of the Census

## LITIGATION

The state is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See “LITIGATION” in the main body of the Official Statement.

### **Challenge Seeking Payment to Teachers’ Retirement Board**

In May 2003, the Legislature enacted legislation (Chapter 6, Statutes of 2003–04, First Extraordinary Session, Senate Bill No. 20, “SBX1 20”) that deferred the payment of \$500 million to CalSTRS’s Supplemental Benefit Maintenance Account (“SBMA”). SBX1 20 also establishes an appropriation of an amount not to exceed \$500 million, adjusted by the actual rate of return to funds in the SBMA, in 2006 and every four years thereafter, for the purpose of funding the SBMA. The actual amount of such appropriation, if any, will be determined following a report by the CalSTRS managing board that the funds in the SBMA will be insufficient in any fiscal year before July 1, 2036, to provide certain payments to CalSTRS members, and the certification of the amount of any such appropriation by the State’s Director of Finance. On October 14, 2003, the CalSTRS board and certain CalSTRS members filed a complaint in the Sacramento County Superior Court as *Teachers’ Retirement Board, as Manager of the California State Teachers’ Retirement System, et al. v. Tom Campbell, Director of California Department of Finance, and Steve Westly, California State Controller* (Case No. 03CS01503). This lawsuit seeks, primarily, a writ of mandate compelling the State Controller to transfer funds from the State’s General Fund to the SBMA in an amount equal to the continuing appropriation, as it existed prior to the enactment of SBX1 20 (\$500 million plus interest). It also seeks injunctive and declaratory relief to the same effect. The Superior Court granted Plaintiffs’ motion for summary adjudication. The court declared SBX1 20 unconstitutionally impairs CalSTRS members’ vested contractual rights. The court ordered the issuance of a peremptory writ of mandate commanding the State Controller to transfer \$500 million from the General Fund to the SBMA. The judgment will include an award of interest in an as yet unknown amount at the rate of 7 percent (7%) per annum both pre- and post-judgment. However, because the Legislature has not appropriated funds to pay such interest, the Superior Court cannot, and did not, compel the payment of any pre- or post-judgment interest. The state has appealed the decision, and plaintiffs and the intervening California Retired Teachers’ Association have filed cross-appeals. If intervenors’ cross-appeal is successful, pre-judgment interest will be calculated at the rate of 10% per annum on the \$500 million from July 1, 2003, through September 21, 2005. The post-judgment interest rate remains 7% per annum.

### **Action Seeking Modification of Retirement Formula for State Employees**

A recently filed case entitled *Joseph Myers et al v. CalPERS et al.* (Alameda Superior Court, Case No. RG06-262495) alleges that Government Code section 21354.1 violates the age discrimination provisions of the Fair Employment and Housing Act. The lawsuit, plead as a class action on behalf of state employees over age 55 who will retire after January 1, 2001, asserts that the statute “discriminates” against older workers because the change in the retirement formulas it implemented gives them a smaller percentage increase in benefits than it provided to younger workers. The complaint seeks injunctive relief and retroactive retirement benefits of an unspecified nature. It is unclear from the complaint what retroactive retirement benefits are being sought, or whether they would be offset by reductions in benefits to younger workers, and thus it is impossible at this time to quantify the magnitude of the fiscal impact; however, it may be in excess of \$250 million. The state’s demurrer to the entire complaint (which is plead as a single cause of action) was sustained with leave to amend. The Court ruled that plaintiffs must state facts from which it can be inferred that the retirement formulas being challenged are not required by state or federal law.

## Tax Refund Cases

Six pending cases challenge the Franchise Tax Board's treatment of proceeds from the investment of cash in short-term financial instruments, and the resulting impact on the apportionment of corporate income to the corporation's California tax obligation. The state has advanced two separate theories to sustain its tax assessments. In *General Motors Corp. v. Franchise Tax Board* the California Supreme Court has granted General Motors's petition for review of the appellate court's affirmation of a ruling in favor of the Franchise Tax Board (*General Motors Corp. v. Franchise Tax Board*, Case No. S127086) on one of the theories, and in *Microsoft Corporation v. Franchise Tax Board* it granted review of the appellate court's reversal of a ruling in favor of Microsoft on the same issue but on the other theory (*Microsoft Corporation v. Franchise Tax Board* (Case No. S133343)). The state's tax assessments have been sustained in both of these cases but on different grounds. On February 25, 2005, the Court of Appeal, First Appellate District issued an unpublished opinion in *The Limited Stores, Inc. and Affiliates v. Franchise Tax Board* (Case No. A102915) upholding the judgment entered in favor of the Franchise Tax Board. On June 8, 2005, the California Supreme Court granted review in this case and directed that it be held pending decisions in *Microsoft* and *General Motors*. In *Toys "R" Us, Inc. v. Franchise Tax Board* the Court of Appeal, Third Appellate District (Case No. C045386) sustained the trial court's ruling in favor of the Franchise Tax Board in a decision similar to that in *Microsoft*. That decision, however, rejected the rationale adopted by the Court of Appeal in *General Motors*. The California Supreme Court has granted review but deferred briefing. *Montgomery Ward LLC v. Franchise Tax Board* is pending in the San Diego Superior Court (Case No. 802767), and *Colgate-Palmolive v. Franchise Tax Board* is pending in the Sacramento County Superior Court (Case No. 03AS00707); the *Colgate* matter has been stayed, pending the Supreme Court's decision in *General Motors*. Other taxpayers have raised this same issue in administrative actions. A final decision in favor of any of these plaintiffs could result in tax refunds to similarly situated taxpayers in an amount exceeding \$600 million, with a potential future annual revenue loss of \$85 million. The state is vigorously litigating this issue.

Also in *General Motors Corp v. Franchise Tax Board* (discussed above, Case No. S127086), the California Supreme Court granted the taxpayer's petition for review to determine whether the Franchise Tax Board's practice of allowing tax credits on an entity basis rather than to a unitary business is correct. A decision in favor of the taxpayer could result in the refund of taxes in excess of \$300 million for prior years and an ongoing reduction in tax revenues of approximately \$80 million.

On August 17, 2006, the California Supreme Court filed its decisions in *Microsoft* and *General Motors*. In *Microsoft*, the Court affirmed the judgment in favor of the Franchise Tax Board. The Court concluded that while returned principal from investments in short-term investments financial instruments is a "receipt" for income apportionment purposes, the inclusion of returned principal in the income calculation results in an apportionment percentage that does not fairly reflect Microsoft's business activities in California. The Court therefore upheld Franchise Tax Board's use of an alternative apportionment method under Revenue and Taxation Code § 25137 that excluded returned principal from the calculation. In *General Motors*, the Court affirmed the Court of Appeal decision in favor of the Franchise Tax Board on the research credit issue and affirmed in substantial part the lower courts' decisions on the apportionment issue. As in *Microsoft*, the Court held that returned principal was a receipt, but also held that only the interest portion of proceeds from repurchase transactions could be included in the income apportionment calculation. The Court remanded the case for a determination whether the inclusion of returned principal in the income apportionment calculation was distortive of the taxpayer's business activities in California, as the Court had held in *Microsoft*. Petition for rehearing has been filed by the Franchise Tax Board to clarify portions of these decisions.

Two pending cases challenge the Franchise Tax Board's LLC fees imposed by Revenue and Taxation Code section 17942. In *Northwest Energetic Services, LLC v. Franchise Tax Board*

(San Francisco Superior CGC-05-437721) plaintiff seeks a refund of fees, interest and penalties paid for 1997-2001, and in *Ventas Finance I, LLC v. Franchise Tax Board* (San Francisco Superior Court 05-440001), plaintiff seeks a refund for 2001-2003. In both cases the plaintiffs allege that section 17942 is unconstitutional on its face and as applied because it discriminates against interstate commerce and violates the Due Process and Equal Protection clauses. In the alternative, the plaintiffs also allege that the Franchise Tax Board misinterprets section 17942 and that section 17942 is an improper exercise of the state's police powers. A final decision in favor of these plaintiffs applied to all taxpayers similarly situated could result in loss of annual revenue in excess of \$400 million and potential refunds exceeding \$1.12 billion. In the *Northwest* case, the trial court has entered judgment in favor of the plaintiffs. The Franchise Tax Board has filed an appeal.

In *General Electric Company & Subsidiaries v. Franchise Tax Board* (San Francisco Superior Court, CGC 06-449157), plaintiffs allege the tax amnesty program's amnesty penalty is unconstitutional. Chapter 226, Statutes of 2004 (SB 1100) created an amnesty program for taxable years beginning before January 1, 2003. Under the program, taxpayers that had not paid or had underpaid an eligible tax could agree to pay the tax and waive their rights to claim refunds thereof. In exchange, certain penalties and fees associated with the unpaid taxes would be waived and no criminal actions would be brought for the taxable years for which amnesty was allowed. SB 1100 also imposed a new penalty equal to 50 percent of accrued interest through the amnesty period (February 1, 2005, to March 31, 2005) on unpaid tax liabilities for taxable years for which amnesty could have been requested. General Electric seeks a declaration that the amnesty penalty should not apply to tax liabilities that become final after the amnesty period and that are paid within the statutory payment period, or alternatively, that the amnesty penalty is unconstitutional because it violates due process. The superior court has sustained the demurrer of defendant Franchise Tax Board to the entire complaint without leave to amend. A proposed judgment for dismissal of the complaint has been submitted to the superior court. Plaintiffs are expected to appeal. The fiscal impact of this case is unknown at this time and is dependent on the court's ruling, but is estimated to be in excess of \$300 million.

### **Environmental Matters**

In a federal Environmental Protection Agency ("U.S. EPA") administrative abatement action entitled *In the Matter of: Leviathan Mine, Alpine County, California, Regional Water Quality Control Board, Lahontan Region, State of California* (U.S. EPA Region IX CERCLA Docket No. 00-16(a)), the state, as owner of the Leviathan Mine, is a party through the Lahontan Regional Water Quality Control Board ("Board"). Also a party is ARCO, the successor in interest to the mining company that caused certain pollution of the mine site. The Leviathan Mine site is listed on the U.S. EPA "Superfund" List, and both remediation costs and costs for Natural Resource Damages may be imposed on the state. The alleged bases for the state's liability are the state's ownership of the mine site and the terms of a 1983 settlement agreement with ARCO. The Board has undertaken certain remedial action at the mine site, but the U.S. EPA's decision on the interim and final remedies is pending. ARCO has filed several state law claims against the state with the California Victim Compensation and Government Claims Board (an administrative agency with which certain claims must be filed as a prerequisite to litigation seeking damages against the state which was formerly named the Board of Control, the "Government Claims Board"). Litigation on these claims has been tolled by agreement among the parties until October 1, 2006. It is possible these matters could result in a potential loss to the state in excess of \$400 million.

In *Carla Clark, et. al. v. City of Santa Rosa, et. al* (Sonoma County Superior Court, Case No. SCV-227896), 32 plaintiffs who own property or live in Santa Rosa brought a toxic tort case alleging that water wells supplying water to their homes were contaminated by carcinogenic chemicals. The state is sued under a mandatory duty theory premised on an alleged violation of Proposition 65 (The Safe



Drinking Water and Toxic Enforcement Act of 1986). Plaintiffs claim property damage, a variety of physical and psychological maladies including birth defects, medical monitoring costs and damages for fear of cancer. Plaintiffs claim damages exceeding \$400 million. The jury trial in this case recently ended in a mistrial, and the court reconsidered and granted the state's motion for summary judgment. Once judgment in the state's favor is entered, an appeal by the plaintiff is expected.

### **Energy-Related Matters**

In *People v. ACN Energy, Inc., et al.* (Sacramento County Superior Court, Case No. 01AS05497), the court is considering whether and to what extent compensation is due to market participants which have claimed compensation as a result of the Governor's issuance of executive orders, under the California Emergency Service Act, "commandeering" power purchase arrangements held by Pacific Gas & Electric Company ("PG&E") and Southern California Edison ("SCE"), referred to as "block forward contracts." The California Power Exchange, PG&E and other market participants have filed actions for inverse condemnation, recovery under the Emergency Services Act and other causes of action, which are pending in Sacramento County Superior Court, Judicial Council Coordination Proceeding No. 4203. In an administrative proceeding before the Government Claims Board (which was dismissed on procedural grounds), the California Power Exchange stated claims for "commandeering" the block forward contracts in the amount of approximately \$1 billion. The state contends it is not liable for damages as a result of these orders, nor for compensation for inverse condemnation, and that any damages are offset by payments made by the Department of Water Resources for electricity received under the "commandeered" block forward contracts.

### **Escheated Property Claims**

In three pending cases, plaintiffs claim that the State Controller has an obligation to pay interest on private property that has escheated to the state, and that failure to do so constitutes an unconstitutional taking of private property: *Morris v. Westly* (Los Angeles County Superior Court, Case No. BC310200); *Trust Realty Partners v. Westly* (Sacramento County Superior Court, Case No. 04AS02522); and *Coppoletta v. Westley* (Sacramento County Superior Court (Case No. CGC- 05439933). *Morris* lawsuit challenges whether the state's custodial use of escheated funds entitles the claimant to constructive interest and/or actual interest that was earned while the property is in the state's custody. The *Morris* case seeks a class action determination, and identifies a purported class that could be interpreted to include all persons or entities whose property has been taken into custody by the state. On behalf of the articulated class, the plaintiff in *Morris* seeks a declaration that failure to pay interest is an unconstitutional taking and, among other things, an injunction restraining the State Controller from pursuing the practices complained of in the complaint. The trial court in *Morris* has granted the Controller's motion for summary judgment; and ordered judgment be entered in favor of the State. An appeal by plaintiff is likely. The *Trust Realty Partners* lawsuit focuses on the state's elimination of interest payments on unclaimed property claims (Code of Civil Procedure Section 1540, subdivision (c), as amended effective August 11, 2003, "CCP 1540"). The *Trust Realty Partners* case is not styled as class action suit, but in addition to seeking general and special damages in a sum according to proof at trial, the case seeks a common fund recovery and an injunction restraining the State Controller from engaging in the acts alleged in the complaint. In May 2006, the trial court granted an interim order on a motion for summary adjudication ordering the state to pay interest on certain pending claims made before the amendment to CCP 1540. The Controller is challenging this order. The *Coppoletta* case raises issues analogous to those in *Morris* and also asks that the unclaimed property law be construed as creating a trust for the benefit of the true owner. In May 2006, the San Francisco Superior Court entered an order granting the state's motion for summary judgment in *Coppoletta*. This case is over unless plaintiffs file an appeal. On May 10, 2006, the *Coppoletta* plaintiffs filed *Coppoletta v. Westly* (Case No. C 06 3135 WHA) in the United States District Court for the Eastern District of California. The claims in the newly filed federal case are

identical to those in the state court case as to which judgment has been granted. It is the state's position that the claims in the federal case are barred. If the *Morris* case ultimately prevails as a class action, or the injunctions prayed for in the *Trust Realty Partners* cases are issued and upheld, or if the issues raised in any of these cases require the State Controller to pay interest on escheated property or to manage unclaimed property as a trust for the benefit of the true owners, as the plaintiffs allege is required by law, costs to the state could be in excess of \$500 million.

### **Actions Seeking Damages for Alleged Violations of Privacy Rights**

In *Gail Marie Harrington-Wisely, et al. v. State of California, et al.* (Los Angeles County Superior Court, Case No. BC 227373), a proposed class action, plaintiffs seek damages for alleged violations of prison visitors' rights resulting from the Department of Corrections and Rehabilitation's use of a body imaging machine to search visitors entering state prisons for contraband. This matter has been certified as a class action. The superior court granted final judgment in favor of the state. Plaintiffs are expected to appeal. If a court were to revive the damages claims and award damages pursuant to the California Civil Code for every use of the body-imaging machine, damages could be as high as \$3 billion.

A pending case involves due process constitutional challenges to an individual being placed on the state's child abuse central index prior to the conclusion of a noticed hearing: *Gomez v. Saenz, et al.* (Los Angeles County Superior Court, Case No. BC 284896). In another case, the California appellate court held that before a person is placed on the child abuse central index, that person is entitled to a hearing. However, the appellate court did not decide the issue of what type of hearing would be sufficient. That issue is the subject of the current activity at the trial court in *Gomez*. Depending on the type and scope of the hearing that the trial court might order, and the number of individuals currently on the index that might be entitled to a hearing prior to remaining on the index, the costs to the state related to conducting these hearings could be in excess of \$500 million.

The plaintiff in *Gilbert P. Hyatt v. FTB* (State of Nevada, Clark County District Court, A382999) was subject to an audit by the Franchise Tax Board involving a claimed change of residence from California to Nevada. Plaintiff filed a tort action in the State of Nevada alleging a number of separate torts involving privacy rights and interference with his business relationships arising from the Franchise Tax Board's audit. A Nevada jury trial was scheduled for August 2006. The trial judge ordered a stay while the Nevada Supreme Court considers whether to grant a hearing on a writ filed by Hyatt asking for review of the trial court's ruling that Hyatt had not established a causal relation between the FTB's audit and the loss of his licensing business with Japanese companies. It is unknown when a decision will be made as to whether a hearing will be granted. The economic damages claim exceeds \$500 million. The state is vigorously contesting this matter.

### **Action Seeking a Cost of Living Adjustment for CalWORKs Recipients**

The case of *Juana Raquel Guillen, et al. v. Schwarzenegger, et al.* is currently pending before the Court of Appeal (First Appellate District, Division 3; Case No. A106873). The trial court decision on appeal in this case determined that Governor Schwarzenegger's executive order in November 2003, which reduced the Vehicle License Fee charged to vehicle owners and increased the corresponding Vehicle License Fee offset to local governments (See "STATE FINANCES—Local Governments—Vehicle License Fee"), acted as an "increase in tax relief", which, by statute, triggers an upward cost of living adjustment for recipients of CalWORKs program benefits. The petitioners seek a cost of living adjustment, beginning with fiscal year 2003–04. The estimated cost of the state of a final, unappealable determination consistent with the determination of the trial court, is now estimated to be approximately \$350 million.

### **Actions Seeking Program Modifications**

In the following cases, plaintiffs seek court orders or judgments that would require the state to modify existing programs and, except as specified, do not seek monetary damages. Nevertheless, a judgment against the state in any one of these cases could require changes in the challenged program that could result in increased programmatic costs to the state in a future fiscal year in excess of \$250 million. Alternatively, in some circumstances, it may be possible that a judgment against the state could be addressed by legislative changes to the program that would cost less.

The matter of *Conlan v. Bonta* (First Appellate District, Case No. A106278) followed a prior appellate court decision determining that the state's Medi-Cal program violates federal law because the program fails to promptly reimburse medical payments made by patients within the 90-day window prior to submitting an application for Medi-Cal benefits. The state's Medi-Cal program relies on Medi-Cal providers to reimburse beneficiaries for out-of-pocket expenses paid during this retroactive "reimbursement window" period. On remand following this appellate decision, the trial court ordered the Department of Health Services to develop a compliance plan to implement the appellate decision. Since that time the matter has gone back and forth to the appellate court for further direction. The Department of Health Services is continuing to take steps to implement the appellate court's decisions. Following a further hearing, the court ordered the state to expand the scope of costs for which the state must make reimbursements to include out-of-pocket monies actually paid by a beneficiary to Medi-Cal providers for erroneously collected costs on covered services (at Medi-Cal rates) incurred after issuance of a beneficiary's Medi-Cal card. While the impact of the cost of complying with the trial court's plan for reimbursement is unknown, certain estimates of the costs of the administrative due process procedures required by the court, when combined with the cost of reimbursements that the Department of Health Services now believes may not be eligible for federal off-set, and the costs of reimbursing out-of-pocket fees erroneously collected by Medi-Cal providers, may be in excess of \$250 million.

The following case seeks reforms to state programs for the treatment of institutionalized disabled persons. Some rough estimates suggest the financial impact of a judgment against the state defendants could be as high as \$1 billion per year in programmatic costs going forward. The state is vigorously defending this action.

In *Capitol People First v. Department of Developmental Services* (Alameda County Superior Court, Case No. 2002-038715) a consortium of state and national law firms and public-interest groups brought suit against the Department of Finance, California Department of Developmental Services and California Department of Health Services, alleging violations of the Lanterman Act, the ADA, and section 504 of the Rehabilitation Act by defendants needlessly isolating thousands of people with developmental disabilities in large facilities. The case seeks sweeping reforms, including requiring the state to offer a full range of community-based services.

### **Actions Seeking Medi-Cal Reimbursements**

Two cases, each entitled *California Association of Health Facilities ("CAHF") v. Department of Health Services ("DHS")* have been consolidated in the First District Court of Appeal (Case Nos. 03-425819 and 02-415443). CAHF, which represents approximately 1400 skilled-nursing and intermediate-care facilities, filed two separate cases alleging that the Medi-Cal reimbursement rates paid by DHS to providers for, respectively, the 2001-2002 and 2002-2003 rate years were too low. The superior court sustained DHS's demurrers in both cases and entered judgment for DHS. CAHF'S appeal has been fully briefed and the parties are awaiting notification of a date for oral argument. A final decision adverse to DHS in both of the consolidated cases could result in reimbursement costs exceeding \$250 million.

## **Actions to Increase Amount of State Aid for Foster or Adopted Developmentally Disabled Dependent Children**

Ten pending class action lawsuits challenge the amount of aid provided by the state for the care of dependent children (either in foster care or adopted) who have also been determined to be developmentally disabled by a regional center. These cases have been coordinated *Butler v. Department of Social Services*, (Los Angeles Superior Court, Case No. BC329695). Specifically, plaintiffs assert that they were entitled to, but did not receive, the Alternative Residential Model (ARM) rate (also known as dual agency rate) but have instead been receiving the standard AFDC-FC (foster care) rate and/or the AAP (adoption assistance program) rate. A final decision in favor of these plaintiffs could exceed \$450 million. The state is vigorously litigating this issue.

In a statewide class action against Department of Health Services, Department of Social Services and Los Angeles (*Katie A., et al. v. Bonta, et al., U.S. District Court*, Case No. CV 02-05662 AHM (SHx)) plaintiffs seek to expand Medicaid-covered services under the Early and Periodic Screening, Diagnosis and Treatment program for mentally disordered children in foster care to include what plaintiffs call “wraparound services,” therapeutic foster care,” and “comprehensive case management services in a home-like setting.” Plaintiffs allege that the ADA, the Medicaid Act, the Rehabilitation Act, substantive due process, and Government Code section 11135 require these services. Recently, the federal district court issued a preliminary injunction against the state defendants and ordered the state defendants to provide “wraparound services” and “therapeutic foster care” to class members within 120 days. Further, the court ordered the state defendants and plaintiffs to meet and confer both to develop a plan to implement the preliminary injunction and to come to consensus on whether the court should appoint a special master. At this time, it is unknown what financial impact such an unprecedented decision would have on the state’s General Fund.

## **Local Government Mandate Claims and Actions**

In a test claim filed by the County of San Bernardino, now pending before the Commission on State Mandates (the “Commission”) (Medically Indigent Adults, 01-TC-26 County of San Bernardino, Claimant, Statutes 1982, Chapters 328 and 1594), the Commission is being asked to determine the costs incurred by the county to provide state-mandated care of medically indigent adults (“MIAs”). The amount demanded in the claim for un-reimbursed costs for fiscal year 2000-2001 is just over \$9.2 million. The County of San Bernardino’s test claim poses a potential for a negative impact on the General Fund in the amount of the un-reimbursed costs for all similarly situated county claimants for a period of years, as determined by the Commission. Certain estimates of the annual cost of the services rendered by all counties to MIAs exceed \$4 billion. How much of that will be determined to be “un-reimbursed” to the counties by the state is unknown. In recent years, the counties have received approximately \$1 billion annually in vehicle license fee revenue and \$410 million annually in sales tax revenue to fund various public health programs, which include the programs that provide services to MIAs. The state law that authorized the transfer of the vehicle license fee portion of this revenue to the counties and the authority to transfer the revenue to the counties were automatically repealed as a result of a provision of State law, which was triggered as a result of a final decision (*County of San Diego v. Commission on State Mandates, et al.* (1997) 15 Cal. App. 4th 68; petition for review denied by the California Supreme Court) that awarded the County of San Diego un-reimbursed costs for medical services rendered to MIAs. Various regulatory and statutory steps have been and are being taken to address this reduction in revenues.

Two lawsuits are pending in which Orange and San Diego counties claim they are entitled to full and immediate reimbursement of all mandated costs for which the state has not provided full reimbursement. These lawsuits were consolidated in San Diego County Superior Court (*County of San*

*Diego v. State of California, et al.* (Case No. GIC 825109) and *County of Orange v. State of California, et al.* (Case No. GIC 827845)). These plaintiff counties are seeking relief that would divert current budget appropriations away from various state agencies, and to the counties, as full payment for the un-reimbursed costs of implementing a variety of state mandated programs over the last ten years. The County of San Diego has alleged un-reimbursed costs in excess of \$40 million through fiscal year 2003–04 for a variety of programs. The County of Orange has alleged in excess of \$116 million for un-reimbursed state-mandated costs. The effects of a final determination by an appellate court that the state is required to reimburse the counties now in an amount equal to the previously unreimbursed state mandated costs, if applied to each of California’s 58 counties, could result in costs in excess of \$1.5 billion for existing un-reimbursed mandates.

Following a trial, the court entered a declaratory judgment in favor of the counties regarding the amounts owed, and issued a writ of mandate commanding the state to comply with Government Code section 17617 by making equal annual payments to the counties over the 15-year term currently prescribed by statute, or a shorter period should the statute be amended. Final judgment has been entered. The state defendants have appealed, and the counties have cross-appealed.

In January 1987 the Commission determined that a new statutory requirement for completion of a second science course for graduation from high school imposed reimbursable state-mandated costs on school districts. The State Controller reduced claims for teachers’ salaries attributed to the additional science course requirement on the ground that districts were presumed to have laid off non-science teachers to offset any increase in science teachers. On appeal by many school districts the Commission upheld the State Controller’s position. In early 2005 the Superior Court for the County of Sacramento issued a judgment in consolidated cases lead by *San Diego Unified School District, et al., v. Commission on State Mandates, et al* (Sacramento Superior Court, Case No. 03CS01401 and *Woodland Joint Unified School District v. Commission on State Mandates, et al.* (Sacramento Superior Court, Case No. 05CS01401) finding the Controller’s practice was not authorized by law and ordering the Commission to review a re-evaluation of the claims by the Controller. The Commission has determined that the school districts’ claims for extra science teachers’ salaries must be paid in full. It is possible that these claims would add hundreds of millions of dollars to existing state funding responsibility for K-12 education.

### **Actions Seeking to Enjoin Implementation of or Cause Amendment to Certain Tribal Gaming Compacts**

In June 2004, the state entered into amendments to tribal gaming compacts between the state and five Indian Tribes (the “Amended Compacts”). Those Amended Compacts are being challenged as described below. An unfavorable decision to the state in either of the cases described below (or in any future litigation relating to the Amended Compacts) could eliminate future receipts of gaming revenues anticipated to result from the Amended Compacts, and could delay or impair the state’s ability to sell a portion of the revenue stream anticipated to be generated by these Amended Compacts. The state anticipates using the proceeds of that sale to repay existing internal borrowings of transportation funds. See “CURRENT STATE BUDGET—2006 Budget Act– Transportation Funding.”

In *Rincon Band of Luiseno Mission Indians of the Rincon Reservation v. Schwarzenegger, et al.* (U.S. District Court, Case No. 04 CV 1151 W (WMc)) the plaintiff (the “Rincon Band”), a federally recognized Indian Tribe, alleges, in primary part, that a compact entered into between the Rincon Band and the state in 1999, is part of a statewide regulatory framework that limits gaming devices and licenses on non-Indian lands for the stated goal of promoting tribal economic development. The plaintiff further alleges that the Amended Compacts would materially alter these protections, and as such, would constitute an unconstitutional impairment of the Rincon Band’s 1999 compact. The complaint filed by the Rincon Band seeks, among other things, an injunction against the implementation of the Amended

Compacts. It also raises other breach of compact claims. The District Court denied plaintiff's motion for injunctive relief, and dismissed the complaint on a procedural basis as to the impairment claims and on lack of jurisdiction as to the breach of compact claims. The District Court granted Plaintiff's request for re-consideration in part, but dismissed all but four claims that the state failed to negotiate a compact amendment with the Rincon Band in good faith. The injunctive relief denied by the court remains subject to appeal. The state filed a motion for certification and entry of a separate judgment with respect to the four claims that the District Court ordered dismissed including the impairment of compact claims. The District Court granted the state's motion and entered final judgment from which Rincon filed notice of appeal (U.S. Court of Appeals, Ninth Circuit, Case No. 06-055259). The Rincon Band filed their opening brief in June 2006. In that brief, the Rincon Band abandoned its appeal of the claims for relief challenging the validity of the Amended Compacts. However, one of the issues remaining in the appeal involves the total number of gaming device licenses authorized under the 1999 Compacts. In July 2006, the State filed its answering brief, explaining that resolution of the license issue could adversely affect the tribes with the Amended Compacts. Also, in July 2006, the five tribes that are parties to the Amended Compacts filed an amicus brief raising the same point – making it clear that they were necessary and indispensable parties whose ability to carry out their obligations under the Amended Compacts could be affected. On August 14, 2006, the Rincon Band filed its reply brief.

*California Commerce Casino, Inc., et al. v. Schwarzenegger, et al.* (Los Angeles Superior Court, Case No. BS097163) is an action brought by the owner of a card room and an individual plaintiff and petitioner, challenging the Legislature's ratification of the Amended Compacts, which was done through urgency legislation (Statutes 2004, Chapter 91; "Chapter 91"). Plaintiffs and petitioners allege that Chapter 91 violates a provision of the California Constitution, which bars the grant of vested rights or franchises in an urgency measure, and allege a variety of special privileges and vested rights and interests purportedly created by Chapter 91. The complaint also alleges that Chapter 91 violates provisions of the California Constitution which prohibit certain borrowings to fund a year-end state budget deficit; and constitutes an unconstitutional attempt to contract away the state's police power. Plaintiffs and petitioners seek an injunction restraining the implementation of Chapter 91; a decision prohibiting the implementation of Chapter 91; and a declaration that Chapter 91 is unconstitutional. Defendant's filed a demurrer to the complaint, which was granted, without leave to amend, on October 25, 2005. In granting the demurrer, the court found that: (1) all nine claims were barred by the 60 day statute of limitations in Chapter 91 and (2) the plaintiffs failed and, because of sovereign immunity, were not able to name the five affected tribes as necessary and indispensable parties. The court dismissed the case with prejudice; and plaintiffs have appealed this decision. Briefing is underway. (Court of Appeal, Second Appellate District, Case No. B188220).

*Hollywood Park Land Co., et al. v. Golden State Transportation, et al.* (Sacramento Superior Court, Case No. 06AS00166) is a reverse validation action brought by various horse racetrack interests, challenging validity of the proposed issuance of tribal gaming bonds. The plaintiffs legal theories and complaint are virtually identical to the legal theories and complaint in *California Commerce Casino, Inc., et al. v. Schwarzenegger, et al.* described in the paragraph above, ("*Commerce Casino*".) Specifically, this case claims that the bonds and bond documents would (1) result in unconstitutional contracting away of the state's police power to regulate gaming; and (2) trigger an unconstitutional grant of a franchise, special privilege and/or vested right contained in Compacts. In addition, plaintiffs allege Chapter 91, and the use of bond proceeds as described therein, would violate Proposition 58. Plaintiffs have sought injunctive relief. The *Commerce Casino* plaintiffs filed a notice of appearance in this case contesting the validity of the bonds and bond documents. In addition, the Gabrielino-Tongva Tribe and a tribal councilman, filed a notice of appearance and written response contesting the validity of the bonds and the bond contracts. Additionally, they seek to have the tribal-state exclusivity provisions of the Amended Compacts declared invalid and void and a declaration that CCP Section 1811 is unconstitutional as violating the due process rights of the tribe and its members.

A recently filed case entitled *San Pasqual Band of Mission Indians v. State of California, et al.* (U.S. District Court, Case No. 06 CV 0988) asserts that the slot machine licenses that the five Indian Tribes to the Amended Compacts (the “Five Tribes”) were required to keep in operation as a condition of being allowed access to additional slot machines are available for issuance through the license draw process provided for in the 1999 compacts. The complaint seeks declaratory relief and an order requiring the licenses of the Five Tribes be redistributed or made available to other tribes. Should relief be granted, and the state be ordered to redistribute the licenses, the authority of the Five Tribes to continue to operate the slot machines currently covered by those licenses would be rendered uncertain under the Amended Compacts, which do not contemplate the Five Tribes losing their licenses to operate those machines. The loss of these licenses would thus present questions about the monetary obligations of the Five Tribes that would presumably be required to be addressed by amendment of the Amended Compacts.

### **Matter Seeking Validation of Pension Obligation Bonds**

The Legislature enacted the California Pension Restructuring Bond Act of 2004 (Government Code sections 16940 et seq.), which authorized the Pension Obligation Bond Committee (the “Committee”) to issue bonds to fund all or a portion of the state’s pension obligation in any two fiscal years. Pursuant to that authorization, the Committee authorized the issuance of bonds in an amount not to exceed \$960 million to pay a portion of the state’s pension obligation for fiscal year 2004–05. The Committee also resolved to seek court validation of the bonds and the indenture pertaining to the bonds pursuant to a validation process established by Code of Civil Procedure Sections 860 et seq. The Committee filed *Pension Obligation Bond Committee v. All Persons Interested in the Matter of the Validity of the State of California’s Pension Obligation, etc.* (Sacramento County Superior Court, Case No. 04AS04303). The trial court found that the bonds were not valid under the state’s debt limit. The Committee has appealed and briefing is underway (Court of Appeal, Third Appellate District, Case No. C051749). The state will not be able to issue pension obligation bonds until this matter is finally resolved.

### **Prison Healthcare Reform**

*Plata v. Schwarzenegger* (U.S. District Court case no. C-01-1351 THE) is a class action regarding all prison medical care in the state. Plaintiffs alleged that the state was not providing constitutionally adequate medical care as required by the Eighth Amendment to the U.S. Constitution. The case was settled in 2002, but the federal court retained jurisdiction to enforce the terms of a stipulated judgment. The judgment set up a team of experts to evaluate the adequacy of the medical care delivery system and propose solutions to fulfill the state’s obligations to plaintiffs under the Eighth Amendment to the U.S. Constitution. On June 30, 2005, the district court ruled from the bench that he would appoint a receiver to run and operate the approximately \$750 million adult health care delivery system (excluding mental health and dental care) of the California Department of Corrections and Rehabilitation (“CDCR”), affecting approximately 32 prisons throughout the state (excluding Pelican Bay State Prison). On October 3, 2005, the district court issued two orders: (1) Findings of Fact and Conclusions of Law Re: Appointment of Receiver; and (2) Order Appointing Court Expert to “assist the Court in identifying discrete, urgently needed, remedial measures,” including providing clinical staff at those institutions with the greatest immediate need, pending the appointment of a receiver. The Court appointed a receiver in February 2006, began his official duties in mid-April 2006. One of the receiver’s first tasks is to focus on improving the health care system at San Quentin State Prison. On a system-wide level, the receiver will be issuing a Request for Proposals to contract out the management of the CDCR pharmacy system. At this time, it is unknown what financial impact such an unprecedented decision would have on the state’s General Fund.

### **Action Seeking Recalculation of Proposition 98 Minimum Funding Guarantee**

On August 8, 2005, a lawsuit titled *California Teachers Association et al v. Arnold Schwarzenegger et al.* (Sacramento County Superior Court, Case No. 05CS01165) was filed. Plaintiffs - California Teachers Association, California Superintendent of Public Instruction Jack O'Connell, and various other individuals - allege that the California Constitution's minimum school requirement was not met in fiscal years 2004-05 and 2005-06. Plaintiffs allege an underfunding of approximately \$3.1 billion for the two fiscal years. Plaintiffs seek a writ of mandate requiring the state to recalculate the minimum-funding guarantee in compliance with Article XVI, Section 8 of the California Constitution and declaratory relief finding that the state failed to appropriate sufficient funds to comply with the minimum funding requirement. On May 10, 2006, counsel for all parties executed a settlement agreement. On May 15, 2006 the court issued an order staying the action pending implementation of the agreement by the passage of implementing legislation by the Legislature.

The settlement calls for the payment of the outstanding balance of the minimum funding obligation to school districts and community college districts, approximately \$3 billion, as follows: \$300 million in fiscal year 2007-2008, and \$450 million in fiscal year 2008-2009 and each year thereafter, until the entire minimum funding obligation has been paid. The final payment is expected to occur in approximately 2013-2014.

### **STATE DEBT TABLES**

The tables which follow provide information on outstanding state debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for state general obligation and lease-purchase bonds, and authorized and outstanding state revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the state expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the state to pay principal and interest on the bonds from the General Fund.

"Special Revenue Fund bonds" also known as "Economic Recovery Bonds," are "self liquidating" general obligation bonds which are primarily secured by a pledge of a one-quarter cent statewide sales and use tax deposited in the Fiscal Recovery Fund. Debt service payments are made directly from the Fiscal Recovery Fund and not the General Fund. The Special Revenue Fund bonds are also general obligations of the state to which the full faith and credit of the state are pledged to the punctual payment of the principal of and interest thereon.

As of September 6, 2006, the state had \$1,108,550,000 of outstanding commercial paper notes.



**OUTSTANDING STATE DEBT**  
**FISCAL YEARS 2001-02 THROUGH 2005-06**  
**(Dollars in Thousands Except for Per Capita Information)**

	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>
<b>Outstanding Debt(a)</b>					
General Obligation Bonds					
General Fund (Non-Self Liquidating).....	\$ 22,115,362	\$ 26,758,626	\$ 33,028,807	\$ 34,643,757	\$ 37,066,227
Enterprise Fund (Self Liquidating).....	3,211,310	2,801,775	2,210,800	2,084,505	1,960,105
Special Revenue Fund (Self Liquidating).....	\$ 0	\$ 0	\$ 10,896,080	\$ 10,727,305	\$ 9,759,490
Total.....	\$ 25,326,672	\$ 29,560,401	\$ 46,135,687	\$ 47,455,567	\$ 48,785,822
Lease-Purchase Debt.....	6,341,935	6,704,599	7,288,147	7,841,383	7,785,005
Total Outstanding General Obligation Bonds and Lease-Purchase Debt.....	\$ 31,668,607	\$ 36,265,000	\$ 53,423,834	\$ 55,296,950	\$ 56,570,827
<b>Bond Sales During Fiscal Year</b>					
Non-Self Liquidating General Obligation Bonds....	\$ 3,905,025	\$ 5,150,000	\$ 7,816,275	\$ 4,914,740	\$ 5,516,560
Self Liquidating General Obligation Bonds.....	\$ 11,325	\$ 0	\$ 0	\$ 221,475	\$ 0
Self Liquidating Special Fund Revenue Bonds.....	\$ 0	\$ 0	\$ 10,896,080	\$ 0	\$ 0
Lease-Purchase Debt.....	\$ 229,105	\$ 673,975	\$ 1,235,660	\$ 907,955	\$ 882,775
<b>Debt Service (b)</b>					
Non-Self Liquidating General Obligation Bonds....	\$ 2,314,724	\$ 1,738,740	\$ 1,861,972	\$ 3,048,739	\$ 3,121,563
Lease-Purchase Debt.....	\$ 635,844	\$ 659,255	\$ 689,851	\$ 740,976	\$ 804,311
<b>General Fund Receipts (c).....</b>	\$ 66,604,508	\$ 78,587,019	\$ 79,385,818	\$ 87,936,942	\$ 94,302,567
Non-Self Liquidating General Obligation Bonds					
Debt Service as a Percentage of General Fund Receipts.....	3.48%	2.21%	2.35%	3.47%	3.31%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts.....	0.95%	0.84%	0.87%	0.84%	0.85%
<b>Population (d).....</b>	34,784,000	35,393,000	35,990,000	36,506,000	37,005,000
Non-Self Liquidating General Obligation Bonds					
Outstanding per Capita.....	\$ 635.79	\$ 756.04	\$ 917.72	\$ 948.99	\$ 1,001.65
Lease-Purchase Debt Outstanding per Capita.....	\$ 182.32	\$ 189.43	\$ 202.50	\$ 214.80	\$ 210.38
<b>Personal Income (e).....</b>	\$1,135,304,000	\$1,147,716,000	\$1,184,265,000	\$1,262,306,000	\$1,338,181,000
Non-Self Liquidating General Obligation Bonds					
Outstanding as Percentage of Personal Income....	1.95%	2.33%	2.79%	2.74%	2.77%
Lease-Purchase Debt Outstanding as Percentage of Personal Income.....	0.56%	0.58%	0.62%	0.62%	0.58%

(a) As of last day of fiscal year. Includes the initial value of capital appreciation bonds rather than the accreted value.

(b) Calculated on a cash basis. Debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year. For FY 2002-03 and FY2003-04, General Obligation Bond Debt Service was reduced through a debt restructuring program which included the use of proceeds from current refunding bonds to pay certain bonds maturing in those years.

(c) Calculated on a cash basis. General Fund Receipts includes both revenues and nonrevenues, such as borrowings the proceeds of which are deposited in the General Fund (e.g. tobacco securitization bonds).

(d) As of July 1, the beginning of the fiscal year.

(e) Source: U.S. Department of Commerce, Bureau of Economic Analysis, <http://www.bea.gov/>

Annual Totals:"Pre-benchmark" Revisions: Released March 28, 2006. California Department of Finance.

SOURCES: Population: State of California, Department of Finance

Personal Income: State of California, Department of Finance; United States, Department of Commerce, Bureau of Economic Analysis (BEA)

Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.

General Fund Receipts: State of California, Office of the State Controller.

# AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of July 1, 2006

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
<b>GENERAL FUND BONDS (Non-Self Liquidating)</b>					
1988 School Facilities Bond Act	11/08/88	800,000	341,790	2,255	0
1990 School Facilities Bond Act	06/05/90	800,000	372,860	2,125	0
1992 School Facilities Bond Act	11/03/92	900,000	506,207	3,789	0
California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002	03/05/02	2,600,000	510,900	1,010,560	1,073,410
California Library Construction and Renovation Bond Act of 1988	11/08/88	75,000	39,665	0	2,595
California Park and Recreational Facilities Act of 1984	06/05/84	370,000	79,215	N/A	1,100
California Parklands Act of 1980	11/04/80	285,000	14,390	N/A	0
California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000	03/07/00	350,000	62,125	210,670	64,970
California Safe Drinking Water Bond Law of 1976	06/08/76	175,000	24,430	N/A	2,500
California Safe Drinking Water Bond Law of 1984	11/06/84	75,000	15,835	N/A	0
California Safe Drinking Water Bond Law of 1986	11/04/86	100,000	48,935	N/A	0
California Safe Drinking Water Bond Law of 1988	11/08/88	75,000	43,925	6,975	0
California Wildlife, Coastal, and Park Land Conservation Act	06/07/88	776,000	322,915	N/A	7,330
Children's Hospital Bond Act of 2004	11/02/04	750,000	63,495	525,076	161,430
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (Higher Education)	11/03/98	2,500,000	2,260,040	134,600	0
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (K-12)	11/03/98	6,700,000	6,028,510	11,860	0
Clean Air and Transportation Improvement Bond Act of 1990	06/05/90	1,990,000	1,244,125	194,285	15,630
Clean Water Bond Law of 1970	11/03/70	250,000	2,500	N/A	0
Clean Water Bond Law of 1974	06/04/74	250,000	5,605	N/A	0
Clean Water Bond Law of 1984	11/06/84	325,000	53,320	N/A	0
Clean Water and Water Conservation Bond Law of 1978	06/06/78	375,000	15,665	N/A	0
Clean Water and Water Reclamation Bond Law of 1988	11/08/88	65,000	41,805	0	0
Community Parklands Act of 1986	06/03/86	100,000	27,975	N/A	0
County Correctional Facility Capital Expenditure Bond Act of 1986	06/03/86	495,000	147,955	N/A	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/08/88	500,000	252,395	0	0
County Jail Capital Expenditure Bond Act of 1981	11/02/82	280,000	23,400	N/A	0
County Jail Capital Expenditure Bond Act of 1984	06/05/84	250,000	17,400	N/A	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	06/05/90	300,000	214,085	28,300	0

# AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of July 1, 2006

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
<b>GENERAL FUND BONDS (Non-Self Liquidating)</b>					
Fish and Wildlife Habitat Enhancement Act of 1984	06/05/84	85,000	18,135	N/A	0
Hazardous Substance Cleanup Bond Act of 1984	11/06/84	100,000	0	N/A	0
Higher Education Facilities Bond Act of 1986	11/04/86	400,000	71,900	N/A	0
Higher Education Facilities Bond Act of 1988	11/08/88	600,000	236,460	0	10,440
Higher Education Facilities Bond Act of June 1990	06/05/90	450,000	208,615	980	1,130
Higher Education Facilities Bond Act of June 1992	06/02/92	900,000	578,310	0	7,235
Housing and Emergency Shelter Trust Fund Act of 2002	11/05/02	2,100,000	28,790	1,200,000	871,125
Housing and Homeless Bond Act of 1990	06/05/90	150,000	5,530	N/A	0
Kindergarten-University Public Education Facilities Bond Act of 2002 (Higher Education)	11/05/02	1,650,000	641,440	997,990	0
Kindergarten-University Public Education Facilities Bond Act of 2002 (K-12)	11/05/02	11,400,000	9,327,125	1,955,980	0
Kindergarten-University Public Education Facilities Bond Act of 2004 (Hi-Ed)	03/02/04	2,300,000	20,845	705,316	1,573,524
Kindergarten-University Public Education Facilities Bond Act of 2004 (K-12)	03/02/04	10,000,000	2,393,800	7,603,580	0
Lake Tahoe Acquisitions Bond Act	08/02/82	85,000	15,480	N/A	0
New Prison Construction Bond Act of 1981	06/08/82	495,000	0	N/A	0
New Prison Construction Bond Act of 1984	06/05/84	300,000	0	N/A	0
New Prison Construction Bond Act of 1986	11/04/86	500,000	105,050	N/A	0
New Prison Construction Bond Act of 1988	11/08/88	817,000	325,755	7,190	0
New Prison Construction Bond Act of 1990	06/05/90	450,000	190,005	2,057	298
Passenger Rail and Clean Air Bond Act of 1990	06/05/90	1,000,000	487,145	0	0
Public Education Facilities Bond Act of 1996 (Higher Education)	03/26/96	975,000	805,360	0	37,465
Public Education Facilities Bond Act of 1996 (K-12)	03/26/96	2,025,000	1,584,860	12,965	0
Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act	03/07/00	1,970,000	783,660	609,014	487,949
Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000	03/07/00	2,100,000	1,260,550	207,790	565,625
Safe, Clean, Reliable Water Supply Act	11/05/96	995,000	662,750	276,310	0
School Building and Earthquake Bond Act of 1974	11/05/74	40,000	26,650	N/A	0
School Facilities Bond Act of 1988	06/07/88	800,000	290,090	N/A	0
School Facilities Bond Act of 1990	11/06/90	800,000	417,370	0	0
School Facilities Bond Act of 1992	06/02/92	1,900,000	1,049,295	13,555	0
Seismic Retrofit Bond Act of 1996	03/26/96	2,000,000	1,630,195	143,870	0

# AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of July 1, 2006

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
<b>GENERAL FUND BONDS (Non-Self Liquidating)</b>					
Senior Center Bond Act of 1984	11/06/84	50,000	0	N/A	0
State Beach, Park, Recreational and Historical Facilities Bond Act of 1974	06/04/74	250,000	0	N/A	0
State School Building Lease-Purchase Bond Law of 1982	11/02/82	500,000	0	N/A	0
State School Building Lease-Purchase Bond Law of 1984	11/06/84	450,000	46,250	N/A	0
State School Building Lease-Purchase Bond Law of 1986	11/04/86	800,000	168,650	N/A	0
State, Urban, and Coastal Park Bond Act of 1976	11/02/76	280,000	10,250	N/A	0
Stem Cell Research and Cures Act of 2004	11/02/04	3,000,000	0	200,000	2,800,000
Veterans Homes Bond Act of 2000	03/07/00	50,000	3,080	31,750	15,170
Voting Modernization Bond Act of 2002	03/05/02	200,000	36,100	137,370	0
Water Conservation Bond Law of 1988	11/08/88	60,000	36,255	9,525	0
Water Conservation and Water Quality Bond Law of 1986	06/03/86	150,000	56,390	N/A	27,600
Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	11/05/02	3,440,000	762,620	557,945	2,107,900
<b>Total General Fund Bonds</b>		<b>79,128,000</b>	<b>37,066,227</b>	<b>16,803,681</b>	<b>9,834,425</b>
<b>ENTERPRISE FUND BONDS (Self Liquidating)</b>					
California Water Resources Development Bond Act	11/08/60	1,750,000	680,515	N/A	167,600
Veterans Bond Act of 1980	06/03/80	750,000	42,500	0	0
Veterans Bond Act of 1982	11/02/82	450,000	89,000	0	0
Veterans Bond Act of 1984	11/06/84	650,000	187,255	0	0
Veterans Bond Act of 1986	06/03/86	850,000	262,115	0	0
Veterans Bond Act of 1988	06/07/88	510,000	233,970	0	0
Veterans Bond Act of 1990	11/06/90	400,000	181,340	0	0
Veterans Bond Act of 1996	11/05/96	400,000	268,995	0	0
Veterans Bond Act of 2000	11/07/00	500,000	14,415	115,570	370,015
<b>Total Enterprise Fund Bonds</b>		<b>6,260,000</b>	<b>1,960,105</b>	<b>115,570</b>	<b>537,615</b>

# AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of July 1, 2006

(Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a)	CP Program Authorized (b)	Unissued (c)
<b>SPECIAL REVENUE FUND BONDS (Self Liquidating)</b>					
Economic Recovery Bond Act	04/10/04	15,000,000	9,759,490	N/A	3,746,000
<b>Total Special Revenue Fund Bonds</b>		15,000,000	9,759,490	0	3,746,000
<b>TOTAL GENERAL OBLIGATION BONDS</b>		100,388,000	48,785,822	16,919,251	14,118,040

(a) Includes the initial value of capital appreciation bonds rather than the accreted value.

(b) Represents the total amount of commercial paper authorized by Finance Committees that could be issued for new money projects. Of this amount, no more than \$1.5 billion of commercial paper principal and interest can be owing at any time. Currently, there is \$330,550,000.00 of commercial paper issued and outstanding. The bond acts marked as "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.

(c) Treats full commercial paper authorization as issued; see footnote(b).

SOURCE: State of California, Office of the Treasurer.

**GENERAL OBLIGATION AND LEASE REVENUE BONDS  
SUMMARY OF DEBT SERVICE REQUIREMENTS**

**As of July 1, 2006**

	<b>Total Debt</b>		
	<b><u>Interest</u></b>	<b><u>Principal (a)</u></b>	<b><u>Total</u></b>
<b>GENERAL OBLIGATION BONDS</b>			
<b><u>GENERAL FUND NON-SELF LIQUIDATING</u></b>			
Fixed Rate	\$ 23,484,183,272.57	\$ 33,666,227,123.47	\$ 57,150,410,396.04
Variable Rate (b)	2,189,380,762.76	3,400,000,000.00	5,589,380,762.76
<b><u>ENTERPRISE FUND SELF LIQUIDATING</u></b>			
Fixed Rate	1,024,140,771.13	1,960,105,000.00	2,984,245,771.13
<b><u>SPECIAL REVENUE FUND SELF LIQUIDATING (c)</u></b>			
Fixed Rate	1,786,813,897.50	5,814,925,000.00	7,601,738,897.50
Variable Rate (d)	1,936,427,777.18	3,944,565,000.00	5,880,992,777.18
<b>REVENUE BONDS</b>			
<b><u>GENERAL FUND LEASE REVENUE</u></b>			
Lease Purchase	<u>4,081,825,567.33</u>	<u>7,785,005,074.62</u>	<u>11,866,830,641.95</u>
<b>General Fund and Lease Revenue Total (e)</b>	<b><u>\$ 34,502,772,048.47</u></b>	<b><u>\$ 56,570,827,198.09</u></b>	<b><u>\$ 91,073,599,246.56</u></b>

(a) Includes scheduled mandatory sinking fund payments.

(b) The estimate of future interest payments is based on rates in effect as of July 1, 2006.

(c) Economic Recovery Bonds.

(d) The estimate of future interest payments is based on rates in effect as of June 1, 2006. \$1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.

(e) Estimated interest included.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR GENERAL FUND NON-SELF LIQUIDATING BONDS**

**Fixed Rate  
As of July 1, 2006**

<b>Fiscal Year Ending June 30</b>	<b>Current Debt</b>		
	<b><u>Interest</u></b>	<b><u>Principal (a)</u></b>	<b><u>Total</u></b>
2007	1,689,137,765.79	1,414,360,000.00	3,103,497,765.79 (b)
2008	1,630,752,594.18	1,529,368,078.31	3,160,120,672.49
2009	1,548,167,710.00	1,602,850,000.00	3,151,017,710.00
2010	1,461,596,541.30	1,688,755,000.00	3,150,351,541.30
2011	1,372,966,819.84	1,666,174,045.16	3,039,140,865.00
2012	1,279,399,008.69	1,465,305,000.00	2,744,704,008.69
2013	1,207,826,320.00	1,183,620,000.00	2,391,446,320.00
2014	1,150,771,344.64	1,096,145,000.00	2,246,916,344.64
2015	1,098,164,527.19	1,037,825,000.00	2,135,989,527.19
2016	1,045,692,677.71	883,705,000.00	1,929,397,677.71
2017	1,000,262,997.03	857,995,000.00	1,858,257,997.03
2018	957,527,507.95	822,500,000.00	1,780,027,507.95
2019	915,367,480.47	864,460,000.00	1,779,827,480.47
2020	871,015,732.86	986,200,000.00	1,857,215,732.86
2021	822,449,924.77	927,285,000.00	1,749,734,924.77
2022	775,460,323.52	1,127,295,000.00	1,902,755,323.52
2023	718,323,782.06	1,172,620,000.00	1,890,943,782.06
2024	660,372,308.58	1,092,905,000.00	1,753,277,308.58
2025	604,357,692.19	1,263,160,000.00	1,867,517,692.19
2026	542,138,843.79	1,204,545,000.00	1,746,683,843.79
2027	481,902,250.04	1,235,780,000.00	1,717,682,250.04
2028	418,236,656.09	1,327,835,000.00	1,746,071,656.09
2029	352,882,293.12	1,242,970,000.00	1,595,852,293.12
2030	288,890,079.83	1,373,330,000.00	1,662,220,079.83
2031	222,027,329.68	1,110,770,000.00	1,332,797,329.68
2032	165,299,865.00	1,109,630,000.00	1,274,929,865.00
2033	109,582,238.75	997,905,000.00	1,107,487,238.75
2034	60,003,882.50	744,560,000.00	804,563,882.50
2035	25,667,150.00	366,430,000.00	392,097,150.00
2036	7,939,625.00	269,945,000.00	277,884,625.00
<b>Total</b>	<b><u>\$23,484,183,272.57</u></b>	<b><u>\$33,666,227,123.47</u></b>	<b><u>\$57,150,410,396.04</u></b>

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining debt service requirements from August 1, 2006 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR GENERAL FUND NON-SELF LIQUIDATING BONDS  
Variable Rate  
As of July 1, 2006**

<b>Fiscal Year Ending June 30</b>	<b>Current Debt</b>		
	<b>Interest (a)</b>	<b>Principal (b)</b>	<b>Total</b>
2007	120,378,686.17	19,000,000.00	139,378,686.17 (c)
2008	130,448,715.34	0.00	130,448,715.34
2009	129,828,555.78	0.00	129,828,555.78
2010	129,971,413.33	0.00	129,971,413.33
2011	130,306,830.00	0.00	130,306,830.00
2012	130,132,312.57	0.00	130,132,312.57
2013	130,412,336.61	0.00	130,412,336.61
2014	129,648,724.30	0.00	129,648,724.30
2015	129,663,307.63	0.00	129,663,307.63
2016	130,281,220.68	67,455,000.00	197,736,220.68
2017	126,026,332.51	372,685,000.00	498,711,332.51
2018	111,719,697.76	476,190,000.00	587,909,697.76
2019	94,113,974.59	238,680,000.00	332,793,974.59
2020	84,258,518.56	230,050,000.00	314,308,518.56
2021	75,712,158.40	183,510,000.00	259,222,158.40
2022	69,272,395.87	97,060,000.00	166,332,395.87
2023	65,217,288.16	119,800,000.00	185,017,288.16
2024	60,336,697.37	296,540,000.00	356,876,697.37
2025	48,895,163.40	201,180,000.00	250,075,163.40
2026	40,540,801.41	346,030,000.00	386,570,801.41
2027	28,111,897.63	74,285,000.00	102,396,897.63
2028	25,475,204.23	77,260,000.00	102,735,204.23
2029	22,287,998.53	110,350,000.00	132,637,998.53
2030	18,203,317.40	114,760,000.00	132,963,317.40
2031	13,802,426.25	119,350,000.00	133,152,426.25
2032	9,368,407.32	124,125,000.00	133,493,407.32
2033	4,640,223.42	129,090,000.00	133,730,223.42
2034	96,108.38	1,600,000.00	1,696,108.38
2035	38,880.00	0.00	38,880.00
2036	39,048.51	0.00	39,048.51
2037	38,711.49	0.00	38,711.49
2038	38,880.00	0.00	38,880.00
2039	38,880.00	0.00	38,880.00
2040	35,649.17	1,000,000.00	1,035,649.17
<b>Total</b>	<b>\$2,189,380,762.76</b>	<b>\$3,400,000,000.00</b>	<b>\$5,589,380,762.77</b>

(a) The estimate of future interest payments is based on rates in effect as of July 1, 2006. The interest rates for the daily, weekly and auction rate bonds range from 3.64 - 3.97%.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from August 1, 2006 through June 30, 2006.

SOURCE: State of California, Office of the Treasurer.



**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR SPECIAL REVENUE FUND SELF LIQUIDATING BONDS**

**Fixed Rate**

**As of July 1, 2006**

<b>Fiscal Year Ending June 30</b>	<b>Current Debt</b>		
	<b><u>Interest</u></b>	<b><u>Principal (a)</u></b>	<b><u>Total</u></b>
2007	144,240,253.23	185,530,000.00	329,770,253.23 (b)
2008	276,067,262.50	393,925,000.00	669,992,262.50
2009	256,912,012.50	449,920,000.00	706,832,012.50
2010	234,396,687.50	506,870,000.00	741,266,687.50
2011	208,777,650.00	549,060,000.00	757,837,650.00
2012	180,544,622.50	289,375,000.00	469,919,622.50
2013	158,128,415.00	603,520,000.00	761,648,415.00
2014	127,216,935.00	606,870,000.00	734,086,935.00
2015	95,264,431.77	636,645,000.00	731,909,431.77
2016	61,418,235.00	702,140,000.00	763,558,235.00
2017	32,768,530.00	451,820,000.00	484,588,530.00
2018	10,817,612.50	438,250,000.00	449,067,612.50
2019	47,500.00	0.00	47,500.00
2020	47,500.00	0.00	47,500.00
2021	47,500.00	0.00	47,500.00
2022	47,500.00	0.00	47,500.00
2023	47,500.00	0.00	47,500.00
2024	23,750.00	1,000,000.00	1,023,750.00
<b>Total</b>	<b><u>\$1,786,813,897.50</u></b>	<b><u>\$5,814,925,000.00</u></b>	<b><u>\$7,601,738,897.50</u></b>

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining debt service requirements from August 1, 2006 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR  
SPECIAL REVENUE FUND SELF LIQUIDATING BONDS**

**Variable Rate  
As of July 1, 2006**

<b>Fiscal Year Ending June 30</b>	<b>Current Debt</b>		
	<b>Interest (a)</b>	<b>Principal (b)</b>	<b>Total</b>
2007.....	\$ 147,752,688.18	\$ -	\$ 147,752,688.18 (c)
2008.....	155,771,628.12	-	155,771,628.12
2009.....	150,095,464.88	-	150,095,464.88
2010.....	148,496,946.50	-	148,496,946.50
2011.....	148,496,946.50	-	148,496,946.50
2012.....	148,681,482.37	-	148,681,482.37
2013.....	148,943,626.78	-	148,943,626.78
2014.....	148,181,338.43	-	148,181,338.43
2015.....	148,181,338.43	-	148,181,338.43
2016.....	148,681,482.37	-	148,681,482.37
2017.....	146,253,305.63	297,410,000.00	443,663,305.63
2018.....	132,155,066.20	651,985,000.00	784,140,066.20
2019.....	95,601,764.05	985,780,000.00	1,081,381,764.05
2020.....	51,895,050.35	1,002,650,000.00	1,054,545,050.35
2021.....	15,997,460.15	773,865,000.00	789,862,460.15
2022.....	969,874.88	226,625,000.00	227,594,874.88
2023.....	238,775.00	-	238,775.00
2024.....	33,538.36	6,250,000.00	6,283,538.36
<b>Total .....</b>	<b>\$ 1,936,427,777.18</b>	<b>\$ 3,944,565,000.00</b>	<b>\$ 5,880,992,777.18</b>

(a) The estimate of future interest payments is based on rates in effect as of July 1, 2006. The interest rates for the daily and weekly rate bonds range from 3.85-4.00%. \$1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from August 1, 2006 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR ENTERPRISE FUND SELF LIQUIDATING BONDS  
Fixed Rate  
As of July 1, 2006**

<b>Fiscal Year Ending June 30</b>	<b>Current Debt</b>			
	<b><u>Interest</u></b>	<b><u>Principal (a)</u></b>	<b><u>Total</u></b>	
2007	105,631,472.26	126,160,000.00	231,791,472.26	(b)
2008	96,617,986.04	136,430,000.00	233,047,986.04	
2009	86,829,718.75	135,340,000.00	222,169,718.75	
2010	77,556,794.05	118,190,000.00	195,746,794.05	
2011	70,227,072.02	86,480,000.00	156,707,072.02	
2012	65,594,219.75	100,895,000.00	166,489,219.75	
2013	61,222,059.37	93,395,000.00	154,617,059.37	
2014	56,770,503.50	107,720,000.00	164,490,503.50	
2015	51,703,008.05	114,260,000.00	165,963,008.05	
2016	45,912,866.90	121,930,000.00	167,842,866.90	
2017	39,688,996.79	129,925,000.00	169,613,996.79	
2018	34,214,708.99	90,035,000.00	124,249,708.99	
2019	29,981,716.61	85,850,000.00	115,831,716.61	
2020	26,508,908.61	53,340,000.00	79,848,908.61	
2021	23,670,512.50	46,365,000.00	70,035,512.50	
2022	21,158,096.25	41,990,000.00	63,148,096.25	
2023	19,372,992.01	22,480,000.00	41,852,992.01	
2024	18,040,105.52	27,025,000.00	45,065,105.52	
2025	16,406,841.91	34,350,000.00	50,756,841.91	
2026	14,732,973.75	28,805,000.00	43,537,973.75	
2027	13,195,135.00	28,645,000.00	41,840,135.00	
2028	11,828,360.00	22,215,000.00	34,043,360.00	
2029	10,478,760.00	27,955,000.00	38,433,760.00	
2030	8,737,392.50	36,100,000.00	44,837,392.50	
2031	6,821,867.50	33,920,000.00	40,741,867.50	
2032	4,894,975.00	36,375,000.00	41,269,975.00	
2033	2,858,227.50	37,930,000.00	40,788,227.50	
2034	1,565,500.00	10,000,000.00	11,565,500.00	
2035	1,060,500.00	10,000,000.00	11,060,500.00	
2036	631,250.00	7,000,000.00	7,631,250.00	
2037	227,250.00	9,000,000.00	9,227,250.00	
<b>Total</b>	<b><u>\$1,024,140,771.13</u></b>	<b><u>\$1,960,105,000.00</u></b>	<b><u>\$2,984,245,771.13</u></b>	

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining debt service requirements from August 1, 2006 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS  
FOR LEASE-PURCHASE DEBT  
As of July 1, 2006**

<b>Fiscal Year Ending June 30</b>	<b>Current Debt</b>		
	<b><u>Interest</u></b>	<b><u>Principal (a)</u></b>	<b><u>Total</u></b>
2007	395,212,290.91	373,678,920.44	768,891,211.35 (b)
2008	382,897,237.14	388,286,787.98	771,184,025.12
2009	368,172,844.19	410,977,732.44	779,150,576.63
2010	342,583,653.49	401,636,633.76	744,220,287.25
2011	311,655,160.18	414,720,000.00	726,375,160.18
2012	290,905,188.67	400,420,000.00	691,325,188.67
2013	270,450,321.75	411,735,000.00	682,185,321.75
2014	249,310,741.96	417,425,000.00	666,735,741.96
2015	227,559,644.95	440,320,000.00	667,879,644.95
2016	204,724,558.68	424,510,000.00	629,234,558.68
2017	182,330,361.93	432,715,000.00	615,045,361.93
2018	160,074,237.08	450,620,000.00	610,694,237.08
2019	137,291,500.78	413,230,000.00	550,521,500.78
2020	116,111,500.37	387,700,000.00	503,811,500.37
2021	97,477,601.12	328,275,000.00	425,752,601.12
2022	80,614,318.74	304,245,000.00	384,859,318.74
2023	66,493,734.12	257,710,000.00	324,203,734.12
2024	54,251,303.25	174,515,000.00	228,766,303.25
2025	45,428,984.90	183,320,000.00	228,748,984.90
2026	36,626,670.62	174,340,000.00	210,966,670.62
2027	27,723,630.00	183,205,000.00	210,928,630.00
2028	18,444,577.50	176,825,000.00	195,269,577.50
2029	10,230,076.25	117,655,000.00	127,885,076.25
2030	4,472,807.50	86,370,000.00	90,842,807.50
2031	782,621.25	30,570,000.00	31,352,621.25
<b>Total</b>	<b><u>\$4,081,825,567.33</u></b>	<b><u>\$7,785,005,074.62</u></b>	<b><u>\$11,866,830,641.95</u></b>

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining debt service requirements from August 1, 2006 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

**STATE PUBLIC WORKS BOARD AND  
OTHER LEASE-PURCHASE FINANCING  
OUTSTANDING ISSUES  
July 1, 2006**

<u>Name of Issue</u>	<u>Outstanding</u>
<b><u>GENERAL FUND SUPPORTED ISSUES:</u></b>	
<b>State Public Works Board</b>	
California Community Colleges	554,210,000
California Department of Corrections *	2,221,427,876
California Youth Authority	15,610,000
Office of Energy Assessments (a)	44,595,000
The Regents of the University of California (b) *	1,793,567,198
Trustees of the California State University	543,715,000
Various State Office Buildings	1,909,545,000
<b>Total State Public Works Board Issues</b>	<b>\$7,082,670,075</b>
<b>Total Other State Building Lease Purchase Issues (c)</b>	<b>\$702,335,000</b>
<b>Total General Fund Supported Issues</b>	<b>\$7,785,005,075</b>
<b><u>SPECIAL FUND SUPPORTED ISSUES:</u></b>	
East Bay State Building Authority *	55,946,813
San Bernardino Joint Powers Financing Authority	49,355,000
San Francisco State Building Authority (d)	32,425,000
<b>Total Special Fund Supported Issues</b>	<b>\$137,726,813</b>
<b>TOTAL</b>	<b><u><u>\$7,922,731,888</u></u></b>

\* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self-liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) Includes \$162,305,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.

(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

**STATE AGENCY REVENUE BONDS  
AND CONDUIT FINANCING  
As of June 30, 2006**

<b><u>Issuing Agency</u></b>	<b><u>Outstanding<sup>(a)(b)</sup></u></b>
<b><u>State Programs Financing:</u></b>	
California Department of Transportation - GARVEE.....	\$ 525,460,000
California Infrastructure and Economic Development Bank <sup>(c)</sup> .....	413,125,000
California State University.....	2,053,253,000
Department of Water Resources - Central Valley Project.....	2,364,060,000
Department of Water Resources - Power Supply Program.....	10,501,820,000
The Regents of the University of California.....	5,893,755,000
<b><u>Housing Financing:</u></b>	
California Housing Finance Agency.....	7,427,157,837
Veterans Revenue Debenture.....	543,360,000
<b><u>Conduit Financing:</u></b>	
California Alternative Energy and Advanced Transportation Financing Authority.....	53,235,000
California Educational Facilities Authority.....	3,362,045,358
California Health Facilities Financing Authority.....	7,540,949,246
California Infrastructure and Economic Development Bank <sup>(c)</sup> .....	3,881,838,293
California Pollution Control Financing Authority.....	3,674,186,822
California Student Loan Authority.....	38,155,000
<b>TOTAL.....</b>	<b>\$ 48,272,400,556</b>

<sup>(a)</sup> Totals for California Department of Transportation (GARVEE), California State University, Department of Water Resources and Veterans Revenue Debenture were provided by the State of California, Office of the Treasurer. All other totals were provided by the listed issuing agency.

<sup>(b)</sup> Does not include the "tobacco settlement revenue bonds" issued by Golden State Tobacco Securitization Corporation.

<sup>(c)</sup> Does not include \$6 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of four investor-owned electric utility companies representing interests in certain electric rate surcharges.

# **STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS**

**June 2006**



**STEVE WESTLY**  
California State Controller



STEVE WESTLY  
California State Controller

July 10, 2006

Users of the Statement of General Fund Cash Receipts and Disbursements:

Attached are the Statements of General Fund Cash Receipts and Disbursements for the period July 1, 2005 through June 30, 2006. These statements reflect the State of California's General Fund cash position and compare actual receipts and disbursements for the 2005-06 fiscal year to cash flow estimates prepared by the Department of Finance for the 2006-07 May Revision and the 2005-06 Budget Act. These statements are prepared in compliance with Provision 9 of Budget Act item 0840-001-0001.

Attachment A compares actual receipts and disbursements to date for the 2005-06 fiscal year to cash flow estimates published in the 2006-07 May Revision. These cash flow estimates are predicated on projections and assumptions made by the Department of Finance in preparation of the May Revision.

Attachment B compares actual receipts and disbursements to date for the 2005-06 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 2005-06 Budget Act. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available at <http://www.sco.ca.gov/ard/cash/index.shtml>.

Any questions concerning this report may be directed to Michael Carter, Chief Operating Officer, at (916) 552-8080.

Sincerely,

Original Signed By:

STEVE WESTLY



**STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS**  
**A Comparison of Actual to 2006-07 May Revision Estimates**  
**(Amounts in thousands)**  
**Attachment A**

	July 1 through June 30				
	2006				2005
	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
			Amount	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ 6,436,788	\$ 6,436,788	\$ -	-	\$ 538,359
Add Receipts:					
Revenues	93,325,544	93,221,710	103,834	0.1	85,447,296
Nonrevenues	977,023	614,461	362,562	59.0	2,489,646
Total Receipts	94,302,567	93,836,171	466,396	0.5	87,936,942
Less Disbursements:					
State Operations	21,720,678	21,838,093	(117,415)	(0.5)	20,035,355
Local Assistance	67,401,131	70,173,436	(2,772,305)	(4.0)	61,717,948
Capital Outlay	1,450,966	1,558,795	(107,829)	(6.9)	84,665
Nongovernmental	933,779	691,179	242,600	35.1	200,545
Total Disbursements	91,506,554	94,261,503	(2,754,949)	(2.9)	82,038,513
Receipts Over / (Under) Disbursements	2,796,013	(425,332)	3,221,345	-	5,898,429
Net Increase / (Decrease) in Temporary Loans	-	-	-	-	-
GENERAL FUND ENDING CASH BALANCE	9,232,801	6,011,456	3,221,345	53.6	6,436,788
Special Fund for Economic Uncertainties	1,295,007	1,302,023	(7,016)	(0.5)	744,541
TOTAL CASH	\$ 10,527,808	\$ 7,313,479	\$ 3,214,329	44.0	\$ 7,181,329
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 11,708,865	\$ 11,407,884	\$ 300,981	2.6	\$ 10,005,342
Outstanding Loans (b)	-	-	-	-	-
Unused Borrowable Resources	\$ 11,708,865	\$ 11,407,884	\$ 300,981	2.6	\$ 10,005,342

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) A Statement of Estimated Cash Flow for the 2005-06 fiscal year prepared by the Department of Finance for the 2006-07 May Revision. Any projections or estimates are set forth as such and not as representations of fact.
- (b) Cumulative loan balance consisted of no internal or external borrowing.
- (c) Negative balances are the result of repayments received that are greater than disbursements made.
- (d) July 2005 Other Local Assistance includes \$1.1 billion for the motor vehicle license fee "backfill gap" payment to Local Governments.
- (e) Includes School Facility Aid Program that was previously displayed separately.

**SCHEDULE OF CASH RECEIPTS**

(Amounts in thousands)

			July 1 through June 30					
	Month of June		2006					2005
	2006	2005	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual	
					Amount	%		
REVENUES								
Alcoholic Beverage Excise Tax	\$ 31,985	\$ 25,412	\$ 318,518	\$ 313,000	\$ 5,518	1.8	\$ 312,671	
Corporation Tax	1,698,308	1,714,629	10,436,025	10,254,710	181,315	1.8	12,496,503	
Cigarette Tax	3,975	13,416	113,256	116,000	(2,744)	(2.4)	122,206	
Estate, Inheritance, and Gift Tax	1,549	22,367	124,849	115,000	9,849	8.6	452,679	
Insurance Companies Tax	464,393	474,653	2,212,739	2,239,000	(26,261)	(1.2)	2,228,317	
Personal Income Tax	4,985,925	4,409,751	49,946,731	49,966,000	(19,269)	(0.0)	42,476,251	
Retail Sales and Use Taxes	2,861,534	2,798,102	27,537,859	27,384,000	153,859	0.6	25,506,531	
Pooled Money Investment Interest	40,667	25,467	380,111	448,000	(67,889)	(15.2)	167,339	
Not Otherwise Classified	156,654	125,627	2,255,456	2,386,000	(130,544)	(5.5)	1,684,799	
Total Revenues	10,244,990	9,609,424	93,325,544	93,221,710	103,834	0.1	85,447,296	
NONREVENUES								
Transfers from Special Fund for Economic Uncertainties	-	-	-	-	-	-	1,448,000	
Transfers from Other Funds	(44,706)	71,391	240,562	149,335	91,227	61.1	487,988	
Miscellaneous	89,096	32,333	736,461	465,126	271,335	58.3	553,658	
Total Nonrevenues	44,390	103,724	977,023	614,461	362,562	59.0	2,489,646	
Total Receipts	\$ 10,289,380	\$ 9,713,148	\$ 94,302,567	\$ 93,836,171	\$ 466,396	0.5	\$ 87,936,942	

See notes on page 1.

**SCHEDULE OF CASH DISBURSEMENTS**

(Amounts in thousands)

	Month of June		July 1 through June 30					2005
			2006					
	2006	2005	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual	
					Amount	%		
STATE OPERATIONS (c)								
Legislative/Judicial/Executive	\$ 60,130	\$ 57,051	\$ 1,398,060	\$ 1,396,924	\$ 1,136	0.1	\$ 1,298,574	
State and Consumer Services	37,403	40,838	527,951	542,005	(14,054)	(2.6)	509,350	
Business, Transportation and Housing	478	(313)	5,517	4,540	977	21.5	3,386	
Resources	30,834	39,381	790,643	887,730	(97,087)	(10.9)	761,199	
Environmental Protection Agency	7,179	3,323	60,783	59,975	808	1.3	50,461	
Health and Human Services:								
Health Services	16,770	6,494	296,825	293,741	3,084	1.0	258,528	
Mental Health Hospitals	68,891	30,408	731,931	836,307	(104,376)	(12.5)	571,258	
Other Health and Human Services	(28,318)	20,675	661,863	586,859	75,004	12.8	589,512	
Education:								
University of California	10,099	9,982	2,842,562	2,836,229	6,333	0.2	2,670,057	
State Universities and Colleges	277,461	309,709	2,599,834	2,589,700	10,134	0.4	2,488,257	
Other Education	10,089	9,193	154,754	161,071	(6,317)	(3.9)	146,158	
Corrections and Youth Authority	583,571	522,458	7,211,404	7,156,843	54,561	0.8	6,364,036	
General Government	95,242	130,894	1,226,683	1,307,907	(81,224)	(6.2)	1,265,848	
Public Employees Retirement								
System	(138,914)	(138,842)	(1,553)	-	(1,553)	-	(63,151)	
Debt Service	293,751	220,633	3,130,365	3,105,329	25,036	0.8	3,032,522	
Interest on Loans	85,808	152,702	83,056	72,933	10,123	13.9	89,360	
Total State Operations	1,410,474	1,414,586	21,720,678	21,838,093	(117,415)	(0.5)	20,035,355	
LOCAL ASSISTANCE (c)								
Public Schools - K-12	273,680	199,955	31,019,476	33,500,123	(2,480,647)	(7.4)	29,428,525	
Community Colleges	139,257	137,572	3,342,326	3,681,778	(339,452)	(9.2)	3,042,733	
Debt Service-School Building Bonds	-	-	-	(7,961)	7,961	-	-	
Contributions to State Teachers'								
Retirement System	1	-	1,081,064	1,081,064	-	-	1,148,792	
Other Education (e)	61,152	132,492	2,709,883	2,285,177	424,706	18.6	2,325,743	
Corrections and Youth Authority	24,065	136	293,729	341,236	(47,507)	(13.9)	214,051	
Dept. of Alcohol and Drug Program	10,176	(4,502)	222,127	235,651	(13,524)	(5.7)	227,987	
Dept. of Health Services:								
Medical Assistance Program	481,388	987,446	12,148,396	12,753,185	(604,789)	(4.7)	11,484,288	
Other Health Services	41,753	36,429	598,510	379,194	219,316	57.8	495,354	
Dept. of Developmental Services	5,224	32,627	1,697,585	1,837,874	(140,289)	(7.6)	1,604,536	
Dept. of Mental Health	149,330	(138,426)	649,150	436,158	212,992	48.8	98,471	
Dept. of Social Services:								
SSI/SSP/IHSS	413,346	230,553	4,741,450	4,715,322	26,128	0.6	4,580,336	
CalWORKs	105,352	82,207	2,913,578	2,960,959	(47,381)	(1.6)	2,671,866	
Other Social Services	115,323	62,660	1,237,135	1,186,198	50,937	4.3	1,145,377	
Tax Relief	2,159	6,594	662,584	666,759	(4,175)	(0.6)	667,334	
Other Local Assistance (d)	68,332	70,393	4,084,138	4,120,719	(36,581)	(0.9)	2,582,555	
Total Local Assistance	1,890,538	1,836,136	67,401,131	70,173,436	(2,772,305)	(4.0)	61,717,948	

See notes on page 1.

(Continued)

**SCHEDULE OF CASH DISBURSEMENTS (Continued)**

(Amounts in thousands)

	Month of June		July 1 through June 30				
			2006		2005		
	2006	2005	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
					Amount	%	
<b>CAPITAL OUTLAY</b>	<b>382,077</b>	<b>13,646</b>	<b>1,450,966</b>	<b>1,558,795</b>	<b>(107,829)</b>	<b>(6.9)</b>	<b>84,665</b>
<b>NONGOVERNMENTAL (c)</b>							
Transfer to Special Fund for Economic Uncertainties	(104,807)	-	557,439	557,439	-	-	-
Transfer to Other Funds	15,045	45,950	232,993	174,832	58,161	33.3	141,938
Transfer to Revolving Fund	(32,398)	(17,674)	20,195	-	20,195	-	35,650
Advance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	-
Social Welfare Federal Fund	22,410	(1,061)	19,246	-	19,246	-	(37,582)
Tax Relief and Refund Account	(22,500)	(56,700)	-	-	-	-	-
Counties for Social Welfare	664,880	560,974	103,906	(41,092)	144,998	-	60,539
<b>Total Nongovernmental</b>	<b>542,630</b>	<b>531,489</b>	<b>933,779</b>	<b>691,179</b>	<b>242,600</b>	<b>35.1</b>	<b>200,545</b>
<b>Total Disbursements</b>	<b>\$ 4,225,719</b>	<b>\$ 3,795,857</b>	<b>\$ 91,506,554</b>	<b>\$ 94,261,503</b>	<b>\$ (2,754,949)</b>	<b>(2.9)</b>	<b>\$ 82,038,513</b>
<b>TEMPORARY LOANS</b>							
Special Fund for Economic Uncertainties	\$ -	\$ -	\$ -	\$ -	\$ -	-	\$ -
Other Internal Sources	-	-	-	-	-	-	-
Revenue Anticipation Notes	(3,000,000)	(6,000,000)	-	-	-	-	-
<b>Net Increase / (Decrease) Loans</b>	<b>\$ (3,000,000)</b>	<b>\$ (6,000,000)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>-</b>	<b>\$ -</b>

See notes on page 1.

(Concluded)

**COMPARATIVE STATEMENT OF REVENUES RECEIVED**  
**All Governmental Cost Funds**  
**(Amounts in thousands)**

	July 1 through June 30			
	General Fund		Special Funds	
	2006	2005	2006	2005
<b>MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:</b>				
Alcoholic Beverage Excise Taxes	\$ 318,518	\$ 312,671	\$ -	\$ -
Corporation Tax	10,436,025	12,496,503	-	-
Cigarette Tax	113,256	122,206	938,219	1,002,794
Estate, Inheritance, and Gift Tax	124,849	452,679	-	-
Insurance Companies Tax	2,212,739	2,228,317	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	2,860,395	2,880,441
Diesel & Liquid Petroleum Gas	-	-	556,681	523,839
Jet Fuel Tax	-	-	(5,180)	10,966
Vehicle License Fees	-	-	2,247,414	2,143,158
Motor Vehicle Registration and Other Fees	-	-	2,861,631	2,741,376
Personal Income Tax	49,946,731	42,476,251	898,986	173,992
Retail Sales and Use Taxes	27,537,859	25,506,531	7,351,991	6,798,285
Pooled Money Investment Interest	380,111	167,339	452	149
<b>Total Major Taxes, Licenses, and Investment Income</b>	<b>91,070,088</b>	<b>83,762,497</b>	<b>17,710,589</b>	<b>16,275,000</b>
<b>NOT OTHERWISE CLASSIFIED:</b>				
Alcoholic Beverage License Fee	4,672	3,404	40,621	44,400
Electrical Energy Tax	-	-	604,943	574,073
Private Rail Car Tax	6,948	6,577	-	-
Penalties on Traffic Violations	-	-	93,421	92,162
Health Care Receipts	15,179	8,968	-	-
Revenues from State Lands	270,567	185,447	21,430	500
Abandoned Property	334,335	707,306	-	-
Trial Court Revenues	59,860	56,556	1,211,038	1,222,480
Horse Racing Fees	2,391	2,605	35,596	35,836
Miscellaneous	1,561,504	713,936	7,787,092	6,882,047
<b>Not Otherwise Classified</b>	<b>2,255,456</b>	<b>1,684,799</b>	<b>9,794,141</b>	<b>8,851,498</b>
<b>Total Revenues, All Governmental Cost Funds</b>	<b>\$ 93,325,544</b>	<b>\$ 85,447,296</b>	<b>\$ 27,504,730</b>	<b>\$ 25,126,498</b>

See notes on page 1.

**STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS**  
**A Comparison of Actual to 2005-06 Budget Act Estimates**  
**(Amounts in thousands)**  
**Attachment B**

	July 1 through June 30				
	2006				2005
	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
			Amount	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ 6,436,788	\$ 6,436,788	\$ -	-	\$ 538,359
Add Receipts:					
Revenues	93,325,544	83,750,000	9,575,544	11.4	85,447,296
Nonrevenues	977,023	619,102	357,921	57.8	2,489,646
Total Receipts	94,302,567	84,369,102	9,933,465	11.8	87,936,942
Less Disbursements:					
State Operations	21,720,678	21,589,628	131,050	0.6	20,035,355
Local Assistance	67,401,131	68,451,949	(1,050,818)	(1.5)	61,717,948
Capital Outlay	1,450,966	1,425,936	25,030	1.8	84,665
Nongovernmental	933,779	769,488	164,291	21.4	200,545
Total Disbursements	91,506,554	92,237,001	(730,447)	(0.8)	82,038,513
Receipts Over / (Under) Disbursements	2,796,013	(7,867,899)	10,663,912	-	5,898,429
Net Increase / (Decrease) in Temporary Loans	-	1,431,111	(1,431,111)	(100.0)	-
GENERAL FUND ENDING CASH BALANCE	9,232,801	-	9,232,801	-	6,436,788
Special Fund for Economic Uncertainties	1,295,007	-	1,295,007	-	744,541
TOTAL CASH	\$ 10,527,808	\$ -	\$ 10,527,808	-	\$ 7,181,329
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 11,708,865	\$ 10,232,911	\$ 1,475,954	14.4	\$ 10,005,342
Outstanding Loans (b)	-	1,431,111	(1,431,111)	(100.0)	-
Unused Borrowable Resources	\$ 11,708,865	\$ 8,801,800	\$ 2,907,065	33.0	\$ 10,005,342

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) A Statement of Estimated Cash Flow for the 2005-06 fiscal year prepared by the Department of Finance for the Budget Act of 2005. Any projections or estimates are set forth as such and not as representations of fact.
- (b) Cumulative loan balance consisted of no internal or external borrowing.
- (c) Negative balances are the result of repayments received that are greater than disbursements made.
- (d) July 2005 Other Local Assistance includes \$1.1 billion for the motor vehicle license fee "backfill gap" payment to Local Governments.
- (e) Includes School Facility Aid Program that was previously displayed separately.

**SCHEDULE OF CASH RECEIPTS**

(Amounts in thousands)

			July 1 through June 30				
	Month of June		2006				2005
	2006	2005	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
					Amount	%	
REVENUES							
Alcoholic Beverage Excise Tax	\$ 31,985	\$ 25,412	\$ 318,518	\$ 314,000	\$ 4,518	1.4	\$ 312,671
Corporation Tax	1,698,308	1,714,629	10,436,025	8,858,000	1,578,025	17.8	12,496,503
Cigarette Tax	3,975	13,416	113,256	117,000	(3,744)	(3.2)	122,206
Estate, Inheritance, and Gift Tax	1,549	22,367	124,849	69,000	55,849	80.9	452,679
Insurance Companies Tax	464,393	474,653	2,212,739	2,299,000	(86,261)	(3.8)	2,228,317
Personal Income Tax	4,985,925	4,409,751	49,946,731	42,541,000	7,405,731	17.4	42,476,251
Retail Sales and Use Taxes	2,861,534	2,798,102	27,537,859	26,937,000	600,859	2.2	25,506,531
Pooled Money Investment Interest	40,667	25,467	380,111	357,000	23,111	6.5	167,339
Not Otherwise Classified	156,654	125,627	2,255,456	2,258,000	(2,544)	(0.1)	1,684,799
Total Revenues	10,244,990	9,609,424	93,325,544	83,750,000	9,575,544	11.4	85,447,296
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	-	-	-	-	1,448,000
Transfers from Other Funds	(44,706)	71,391	240,562	139,599	100,963	72.3	487,988
Miscellaneous	89,096	32,333	736,461	479,503	256,958	53.6	553,658
Total Nonrevenues	44,390	103,724	977,023	619,102	357,921	57.8	2,489,646
Total Receipts	\$ 10,289,380	\$ 9,713,148	\$ 94,302,567	\$ 84,369,102	\$ 9,933,465	11.8	\$ 87,936,942

See notes on page 1.

**SCHEDULE OF CASH DISBURSEMENTS**

(Amounts in thousands)

	Month of June		July 1 through June 30					2005
	2006	2005	2006					
			Actual	Estimate (a)	Actual Over or (Under) Estimate			
					Amount	%		
STATE OPERATIONS (c)								
Legislative/Judicial/Executive	\$ 60,130	\$ 57,051	\$ 1,398,060	\$ 1,371,490	\$ 26,570	1.9	\$ 1,298,574	
State and Consumer Services	37,403	40,838	527,951	543,534	(15,583)	(2.9)	509,350	
Business, Transportation and Housing	478	(313)	5,517	4,832	685	14.2	3,386	
Resources	30,834	39,381	790,643	859,638	(68,995)	(8.0)	761,199	
Environmental Protection Agency	7,179	3,323	60,783	64,918	(4,135)	(6.4)	50,461	
Health and Human Services:								
Health Services	16,770	6,494	296,825	259,951	36,874	14.2	258,528	
Mental Health Hospitals	68,891	30,408	731,931	855,190	(123,259)	(14.4)	571,258	
Other Health and Human Services	(28,318)	20,675	661,863	577,352	84,511	14.6	589,512	
Education:								
University of California	10,099	9,982	2,842,562	2,840,324	2,238	0.1	2,670,057	
State Universities and Colleges	277,461	309,709	2,599,834	2,607,871	(8,037)	(0.3)	2,488,257	
Other Education	10,089	9,193	154,754	155,959	(1,205)	(0.8)	146,158	
Corrections and Youth Authority	583,571	522,458	7,211,404	6,794,829	416,575	6.1	6,364,036	
General Government	95,242	130,894	1,226,683	1,263,714	(37,031)	(2.9)	1,265,848	
Public Employees Retirement								
System	(138,914)	(138,842)	(1,553)	-	(1,553)	-	(63,151)	
Debt Service	293,751	220,633	3,130,365	3,301,365	(171,000)	(5.2)	3,032,522	
Interest on Loans	85,808	152,702	83,056	88,661	(5,605)	(6.3)	89,360	
Total State Operations	1,410,474	1,414,586	21,720,678	21,589,628	131,050	0.6	20,035,355	
LOCAL ASSISTANCE (c)								
Public Schools - K-12	273,680	199,955	31,019,476	32,198,747	(1,179,271)	(3.7)	29,428,525	
Community Colleges	139,257	137,572	3,342,326	3,446,223	(103,897)	(3.0)	3,042,733	
Debt Service-School Building Bonds	-	-	-	(6,241)	6,241	-	-	
Contributions to State Teachers'								
Retirement System	1	-	1,081,064	1,081,064	-	-	1,148,792	
Other Education (e)	61,152	132,492	2,709,883	2,284,525	425,358	18.6	2,325,743	
Corrections and Youth Authority	24,065	136	293,729	254,434	39,295	15.4	214,051	
Dept. of Alcohol and Drug Program	10,176	(4,502)	222,127	235,191	(13,064)	(5.6)	227,987	
Dept. of Health Services:								
Medical Assistance Program	481,388	987,446	12,148,396	12,905,712	(757,316)	(5.9)	11,484,288	
Other Health Services	41,753	36,429	598,510	412,542	185,968	45.1	495,354	
Dept. of Developmental Services	5,224	32,627	1,697,585	1,873,250	(175,665)	(9.4)	1,604,536	
Dept. of Mental Health	149,330	(138,426)	649,150	438,466	210,684	48.1	98,471	
Dept. of Social Services:								
SSI/SSP/IHSS	413,346	230,553	4,741,450	4,747,314	(5,864)	(0.1)	4,580,336	
CalWORKs	105,352	82,207	2,913,578	2,726,376	187,202	6.9	2,671,866	
Other Social Services	115,323	62,660	1,237,135	1,109,028	128,107	11.6	1,145,377	
Tax Relief	2,159	6,594	662,584	671,396	(8,812)	(1.3)	667,334	
Other Local Assistance (d)	68,332	70,393	4,084,138	4,073,922	10,216	0.3	2,582,555	
Total Local Assistance	1,890,538	1,836,136	67,401,131	68,451,949	(1,050,818)	(1.5)	61,717,948	

See notes on page 1.

(Continued)



**SCHEDULE OF CASH DISBURSEMENTS (Continued)**

(Amounts in thousands)

	Month of June		July 1 through June 30				
	2006	2005	Actual	Estimate (a)	Actual Over or (Under) Estimate		2005
					Amount	%	Actual
CAPITAL OUTLAY	382,077	13,646	1,450,966	1,425,936	25,030	1.8	84,665
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	(104,807)	-	557,439	557,482	(43)	(0.0)	-
Transfer to Other Funds	15,045	45,950	232,993	182,380	50,613	27.8	141,938
Transfer to Revolving Fund	(32,398)	(17,674)	20,195	-	20,195	-	35,650
Advance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	-
Social Welfare Federal Fund	22,410	(1,061)	19,246	-	19,246	-	(37,582)
Tax Relief and Refund Account	(22,500)	(56,700)	-	-	-	-	-
Counties for Social Welfare	664,880	560,974	103,906	29,626	74,280	250.7	60,539
Total Nongovernmental	542,630	531,489	933,779	769,488	164,291	21.4	200,545
Total Disbursements	\$ 4,225,719	\$ 3,795,857	\$ 91,506,554	\$ 92,237,001	\$ (730,447)	(0.8)	\$ 82,038,513
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	\$ -	\$ -	\$ -	\$ 1,302,023	\$ (1,302,023)	(100.0)	\$ -
Other Internal Sources	-	-	-	129,088	(129,088)	(100.0)	-
Revenue Anticipation Notes	(3,000,000)	(6,000,000)	-	-	-	-	-
Net Increase / (Decrease) Loans	\$ (3,000,000)	\$ (6,000,000)	\$ -	\$ 1,431,111	\$ (1,431,111)	(100.0)	\$ -

See notes on page 1.

(Concluded)

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# **STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS**

**July 2006**



**STEVE WESTLY**  
California State Controller



STEVE WESTLY  
California State Controller

August 10, 2006

Users of the Statement of General Fund Cash Receipts and Disbursements:

Attached is the Statement of General Fund Cash Receipts and Disbursements for the period July 1, 2006 through July 31, 2006. This statement reflects the State of California's General Fund cash position and compares actual receipts and disbursements for the 2006-07 fiscal year to cash flow estimates prepared by the Department of Finance for the 2006-07 Budget Act. The statement is prepared in compliance with Provision 9 of Budget Act item 0840-001-0001.

These statements are also available at <http://www.sco.ca.gov/ard/cash/index.shtml>.

Any questions concerning this report may be directed to Michael Carter, Chief Operating Officer, at (916) 552-8080.

Sincerely,

Original Signed By:

STEVE WESTLY

**STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS**  
**A Comparison of Actual to 2006-07 Budget Act Estimates**  
**(Amounts in thousands)**

	July 1 through July 31				
	2006				2005
	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
			Amount	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ 9,232,801	\$ 9,232,801	\$ -	-	\$ 6,436,788
Add Receipts:					
Revenues	3,989,718	4,014,000	(24,282)	(0.6)	3,815,981
Nonrevenues	14,010	(1,042)	15,052	-	42,421
Total Receipts	4,003,728	4,012,958	(9,230)	(0.2)	3,858,402
Less Disbursements:					
State Operations	2,365,442	2,194,097	171,345	7.8	2,180,486
Local Assistance	9,093,520	9,916,958	(823,438)	(8.3)	9,796,665
Capital Outlay	1,221,029	1,231,395	(10,366)	(0.8)	765
Nongovernmental	(592,553)	(515,400)	(77,153)	-	(554,039)
Total Disbursements	12,087,438	12,827,050	(739,612)	(5.8)	11,423,877
Receipts Over / (Under) Disbursements	(8,083,710)	(8,814,092)	730,382	-	(7,565,475)
Net Increase / (Decrease) in Temporary Loans	-	-	-	-	1,128,687
GENERAL FUND ENDING CASH BALANCE	1,149,091	418,709	730,382	174.4	-
Special Fund for Economic Uncertainties	1,295,007	1,295,007	-	-	-
TOTAL CASH	\$ 2,444,098	\$ 1,713,716	\$ 730,382	42.6	\$ -
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 13,679,643	\$ 12,420,196	\$ 1,259,447	10.1	\$ 10,526,209
Outstanding Loans (b)	-	-	-	-	1,128,687
Unused Borrowable Resources	\$ 13,679,643	\$ 12,420,196	\$ 1,259,447	10.1	\$ 9,397,522

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) A Statement of Estimated Cash Flow for the 2006-07 fiscal year prepared by the Department of Finance for the Budget Act of 2006. Any projections or estimates are set forth as such and not as representations of fact.
- (b) Cumulative loan balance consisted of no internal or external borrowing.
- (c) Negative balances are the result of repayments received that are greater than disbursements made.
- (d) Includes School Facility Aid Program that was previously displayed separately.

**SCHEDULE OF CASH RECEIPTS**

(Amounts in thousands)

	Month of July		July 1 through July 31				
			2006				2005
	2006	2005	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
					Amount	%	
REVENUES							
Alcoholic Beverage Excise Tax	\$ 35,181	\$ 27,718	\$ 35,181	\$ 32,000	\$ 3,181	9.9	\$ 27,718
Corporation Tax	301,902	265,205	301,902	242,000	59,902	24.8	265,205
Cigarette Tax	15,802	12,173	15,802	10,000	5,802	58.0	12,173
Estate, Inheritance, and Gift Tax	1,541	20,404	1,541	-	1,541	-	20,404
Insurance Companies Tax	11,932	15,269	11,932	18,000	(6,068)	(33.7)	15,269
Personal Income Tax	2,615,981	2,504,686	2,615,981	2,650,000	(34,019)	(1.3)	2,504,686
Retail Sales and Use Taxes	928,744	878,444	928,744	939,000	(10,256)	(1.1)	878,444
Pooled Money Investment Interest	64,658	34,874	64,658	35,000	29,658	84.7	34,874
Not Otherwise Classified	13,977	57,208	13,977	88,000	(74,023)	(84.1)	57,208
Total Revenues	3,989,718	3,815,981	3,989,718	4,014,000	(24,282)	(0.6)	3,815,981
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfers from Other Funds	3,877	33,084	3,877	(13,159)	17,036	-	33,084
Miscellaneous	10,133	9,337	10,133	12,117	(1,984)	(16.4)	9,337
Total Nonrevenues	14,010	42,421	14,010	(1,042)	15,052	-	42,421
Total Receipts	\$ 4,003,728	\$ 3,858,402	\$ 4,003,728	\$ 4,012,958	\$ (9,230)	(0.2)	\$ 3,858,402

See notes on page 1.

**SCHEDULE OF CASH DISBURSEMENTS**

(Amounts in thousands)

	Month of July		July 1 through July 31					2005
			2006					
	2006	2005	Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual	
					Amount	%		
STATE OPERATIONS (c)								
Legislative/Judicial/Executive	\$ 136,935	\$ 169,199	\$ 136,935	\$ 154,902	\$ (17,967)	(11.6)	\$ 169,199	
State and Consumer Services	66,642	60,975	66,642	49,210	17,432	35.4	60,975	
Business, Transportation and Housing	3,831	4,620	3,831	4,071	(240)	(5.9)	4,620	
Resources	120,164	95,658	120,164	106,522	13,642	12.8	95,658	
Environmental Protection Agency	1,035	4,454	1,035	6,345	(5,310)	(83.7)	4,454	
Health and Human Services:								
Health Services	48,208	32,552	48,208	29,596	18,612	62.9	32,552	
Mental Health Hospitals	73,566	68,282	73,566	101,002	(27,436)	(27.2)	68,282	
Other Health and Human Services	101,987	131,228	101,987	77,921	24,066	30.9	131,228	
Education:								
University of California	318,724	297,744	318,724	339,779	(21,055)	(6.2)	297,744	
State Universities and Colleges	357,632	320,025	357,632	307,255	50,377	16.4	320,025	
Other Education	25,621	21,041	25,621	15,740	9,881	62.8	21,041	
Dept. of Corrections and Rehabilitation	669,975	577,118	669,975	619,523	50,452	8.1	577,118	
General Government	136,196	113,800	136,196	116,725	19,471	16.7	113,800	
Public Employees Retirement								
System	292,594	276,012	292,594	217,219	75,375	34.7	276,012	
Debt Service	12,330	7,713	12,330	47,058	(34,728)	(73.8)	7,713	
Interest on Loans	2	65	2	1,229	(1,227)	(99.8)	65	
Total State Operations	2,365,442	2,180,486	2,365,442	2,194,097	171,345	7.8	2,180,486	
LOCAL ASSISTANCE (c)								
Public Schools - K-12	3,680,563	3,285,313	3,680,563	4,046,109	(365,546)	(9.0)	3,285,313	
Community Colleges	743,927	450,409	743,927	455,639	288,288	63.3	450,409	
Contributions to State Teachers'								
Retirement System	598,391	729,278	598,391	688,437	(90,046)	-	729,278	
Other Education (d)	159,087	196,009	159,087	186,815	(27,728)	(14.8)	196,009	
Dept. of Corrections and Rehabilitation	11,916	199	11,916	581	11,335	1,950.9	199	
Dept. of Alcohol and Drug Program	8,655	128,767	8,655	206,283	(197,628)	(95.8)	128,767	
Dept. of Health Services:								
Medical Assistance Program	1,180,901	1,144,020	1,180,901	1,307,839	(126,938)	(9.7)	1,144,020	
Other Health Services	72,042	39,609	72,042	16,854	55,188	327.4	39,609	
Dept. of Developmental Services	598,109	524,500	598,109	904,703	(306,594)	(33.9)	524,500	
Dept. of Mental Health	5,972	192,296	5,972	(47,923)	53,895	-	192,296	
Dept. of Social Services:								
SSI/SSP/IHSS	1,107,549	952,768	1,107,549	873,236	234,313	26.8	952,768	
CalWORKs	540,840	556,550	540,840	541,984	(1,144)	(0.2)	556,550	
Other Social Services	69,470	131,009	69,470	132,648	(63,178)	(47.6)	131,009	
Tax Relief	5,315	15,585	5,315	154,788	(149,473)	(96.6)	15,585	
Other Local Assistance	310,783	1,450,353	310,783	448,965	(138,182)	(30.8)	1,450,353	
Total Local Assistance	9,093,520	9,796,665	9,093,520	9,916,958	(823,438)	(8.3)	9,796,665	

See notes on page 1.

(Continued)

**SCHEDULE OF CASH DISBURSEMENTS (Continued)**

(Amounts in thousands)

	Month of July		July 1 through July 31				2005 Actual
	2006	2005	2006		Actual Over or (Under) Estimate		
			Actual	Estimate (a)	Amount	%	
CAPITAL OUTLAY	1,221,029	765	1,221,029	1,231,395	(10,366)	(0.8)	765
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfer to Other Funds	84,588	789	84,588	-	84,588	-	789
Transfer to Revolving Fund	9,739	5,351	9,739	-	9,739	-	5,351
Advance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	-
Social Welfare Federal Fund	(22,000)	795	(22,000)	-	(22,000)	-	795
Tax Relief and Refund Account	-	-	-	-	-	-	-
Counties for Social Welfare	(664,880)	(560,974)	(664,880)	(515,400)	(149,480)	-	(560,974)
Total Nongovernmental	(592,553)	(554,039)	(592,553)	(515,400)	(77,153)	-	(554,039)
Total Disbursements	\$ 12,087,438	\$ 11,423,877	\$ 12,087,438	\$ 12,827,050	\$ (739,612)	(5.8)	\$ 11,423,877
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	\$ -	\$ 744,541	\$ -	\$ -	\$ -	-	\$ 744,541
Other Internal Sources	-	384,146	-	-	-	-	384,146
Revenue Anticipation Notes	-	-	-	-	-	-	-
Net Increase / (Decrease) Loans	\$ -	\$ 1,128,687	\$ -	\$ -	\$ -	-	\$ 1,128,687

See notes on page 1.

(Concluded)



**COMPARATIVE STATEMENT OF REVENUES RECEIVED**  
**All Governmental Cost Funds**  
**(Amounts in thousands)**

	July 1 through July 31			
	General Fund		Special Funds	
	2006	2005	2006	2005
<b>MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:</b>				
Alcoholic Beverage Excise Taxes	\$ 35,181	\$ 27,718	\$ -	\$ -
Corporation Tax	301,902	265,205	-	-
Cigarette Tax	15,802	12,173	132,154	100,468
Estate, Inheritance, and Gift Tax	1,541	20,404	-	-
Insurance Companies Tax	11,932	15,269	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	243,362	247,198
Diesel & Liquid Petroleum Gas	-	-	47,024	44,843
Jet Fuel Tax	-	-	294	254
Vehicle License Fees	-	-	164,926	146,309
Motor Vehicle Registration and Other Fees	-	-	191,021	172,418
Personal Income Tax	2,615,981	2,504,686	45,309	41,876
Retail Sales and Use Taxes	928,744	878,444	354,376	315,168
Pooled Money Investment Interest	64,658	34,874	35	-
<b>Total Major Taxes, Licenses, and Investment Income</b>	<b>3,975,741</b>	<b>3,758,773</b>	<b>1,178,501</b>	<b>1,068,534</b>
<b>NOT OTHERWISE CLASSIFIED:</b>				
Alcoholic Beverage License Fee	587	162	6,048	457
Electrical Energy Tax	-	-	2	342
Private Rail Car Tax	-	-	-	-
Penalties on Traffic Violations	-	-	-	-
Health Care Receipts	7	-	-	-
Revenues from State Lands	26,067	608	-	15,430
Abandoned Property	(64,313)	-	-	-
Trial Court Revenues	6,132	5,245	53,569	50,678
Horse Racing Fees	218	176	2,080	2,274
Miscellaneous	45,279	51,017	482,132	522,147
<b>Not Otherwise Classified</b>	<b>13,977</b>	<b>57,208</b>	<b>543,831</b>	<b>591,328</b>
<b>Total Revenues, All Governmental Cost Funds</b>	<b>\$ 3,989,718</b>	<b>\$ 3,815,981</b>	<b>\$ 1,722,332</b>	<b>\$ 1,659,862</b>

See notes on page 1.

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## APPENDIX B

### DTC AND THE BOOK-ENTRY SYSTEM

*The information in the following section entitled “DTC’s Book-Entry System” has been provided by DTC for use in securities offering documents, and the State takes no responsibility for the accuracy or completeness thereof. The State cannot and does not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners either (a) payments of interest, principal or premium, if any, with respect to the Bonds or (b) certificates representing ownership interest in or other confirmation of ownership interest in the Bonds, or that they will so do on a timely basis or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Official Statement. The current “Rules” applicable to DTC are on file with the Securities and Exchange Commission and the current “Procedures” of DTC to be followed in dealing with DTC Participants are on file with DTC.*

The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the bonds (the “Bonds”). The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (“NSCC,” “FICC,” “MBSCC” and “EMCC,” also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the

Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds. DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Bonds. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State Treasurer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, Agent, or the State Treasurer, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

If the State Treasurer determines not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Bonds and the State Treasurer does not select another qualified securities depository, the State will deliver physical Bond certificates to the beneficial owners. The Bonds may thereafter be transferred upon the books of the State Treasurer by the registered owners, in person or by authorized attorney, upon surrender of Bonds at the Office of the State Treasurer

in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form approved by the State Treasurer and upon payment of any charges provided for in the Resolutions. Certificated bonds may be exchanged for Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the State Treasurer in Sacramento, California, upon payment of any charges provided for in the Resolutions. No transfer or exchange of Bonds will be made by the State Treasurer during the period between the record date and the next Interest Payment Date.

THE STATE TREASURER, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE BONDS, WILL SEND ANY NOTICE OF REDEMPTION OR OTHER NOTICES TO OWNERS TO ONLY DTC. ANY FAILURE OF DTC TO ADVISE ANY DTC PARTICIPANT, OR OF ANY DTC PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE REDEMPTION OF THE BONDS CALLED FOR REDEMPTION OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Bonds, payment of principal of and interest and other payments with respect to the Bonds to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Bonds and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE BONDS, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS OF THE BONDS (OTHER THAN UNDER THE CAPTION "TAX MATTERS" HEREIN) SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS.

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## APPENDIX C

### FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (this “Disclosure Certificate”) is executed as of September 14, 2006, by the Treasurer of the State of California (the “State Treasurer”) in connection with the issuance of \$800,000,000 aggregate principal amount of the State of California Various Purpose General Obligation Bonds (the “Bonds”) as authorized by various acts of the State of California legislature (the “Acts”). The Bonds are being issued pursuant to resolutions of finance committees (the “Resolutions”), created under the Acts. Pursuant to the Resolutions, the State Treasurer, on behalf of the State of California (the “State”), covenants and agrees as follows:

SECTION 1. Nature of the Disclosure Certificate. This Disclosure Certificate is executed for the benefit of the Holders and Beneficial Owners (as defined below) of the Bonds from time to time, and in order to assist the Participating Underwriters (as defined below) in complying with the Rule (as defined below), but shall not be deemed to create any monetary liability on the part of the State or the State Treasurer to any other persons, including Holders or Beneficial Owners of the Bonds based on the Rule. The sole remedy in the event of any failure of the State Treasurer to comply with this Disclosure Certificate shall be an action to compel performance of any act required hereunder.

SECTION 2. Definitions. In addition to the definitions set forth in the Resolutions, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

“Annual Report” shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

“Beneficial Owner” shall mean any person who has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

“Central Post Office” means the DisclosureUSA website maintained by the Municipal Advisory Council of Texas or any successor thereto, or any other organization or method approved by the staff or members of the Securities and Exchange Commission (the “SEC”) as an intermediary through which issuers may, in compliance with the Rule, make filings required by this Disclosure Certificate.

“Dissemination Agent” shall mean the State Treasurer, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the State Treasurer.

“Holder” shall mean any person listed on the registration books of the State Treasurer as the registered owner of any Bonds.

“Listed Event” shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

“National Repository” shall mean any Nationally Recognized Municipal Securities Information Repository certified by the SEC to be the recipient of information of the nature of the Annual Reports required by this Disclosure Certificate.

“Official Statement” shall mean the official statement relating to the Bonds, dated September 7, 2006.

“Participating Underwriter” shall mean any original underwriters of the Bonds required to comply with the Rule in connection with the offering of the Bonds.

“Repository” shall mean each National Repository and the State Repository, if any.

“Rule” shall mean Rule 15c2–12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“State” shall mean the State of California.

“State Repository” shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the reports of material events required by this Disclosure Certificate and recognized as such by the SEC. As of the date of this Disclosure Certificate, there is no State Repository.

### SECTION 3. Provision of Annual Reports.

(a) The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the Bonds are outstanding, commencing with the report containing 2005–2006 Fiscal Year financial information, provide an Annual Report consistent with the requirements of this Disclosure Certificate (an “Annual Report”) to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery. The State reserves the right to make this filing through the Central Post Office.

(b) If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report.

(c) If the Dissemination Agent is not the State Treasurer, the Dissemination Agent shall:

1. determine each year prior to the date for filing the Annual Report the name and address of each Repository then certified by the SEC;
2. file a report with the State Treasurer certifying that the Annual Report has been filed pursuant to this Disclosure Certificate and listing all the Repositories with which it was filed and the dates of the filings; and
3. take any other actions mutually agreed to between the Dissemination Agent and the State Treasurer.

SECTION 4. Content of Annual Reports. The Annual Report shall contain or include by reference the following:

(a) The audited Basic Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State’s audited financial statements are not available by the time the Annual Report is required to be filed



pursuant to this Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations; including updating the following tables which appear under the caption APPENDIX A—"THE STATE OF CALIFORNIA—CURRENT STATE BUDGET" in the Official Statement:

Table Entitled

Statement of Revenues, Expenditures, and Changes in Fund Balance—General Fund

Major General Fund Revenue Sources and Expenditures

(c) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A—"THE STATE OF CALIFORNIA—STATE DEBT TABLES" in the Official Statement.

Table Entitled

Outstanding State Debt

Authorized and Outstanding General Obligation Bonds

General Obligation and Lease Revenue Bonds—Summary of Debt Service Requirements

Schedule of Debt Service Requirements for General Fund Non-Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for General Fund Non-Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for Enterprise Fund Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for Lease—Purchase Debt

State Public Works Board and Other  
Lease–Purchase Financing Outstanding Issues

State Agency Revenue Bonds and  
Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents that have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

SECTION 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the State Treasurer, on behalf of the State, shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. principal and interest payment delinquencies;
2. non–payment related defaults;
3. modifications to rights of Holders;
4. optional, contingent or unscheduled bond calls;
5. defeasances;
6. rating changes;
7. adverse tax opinions or events affecting the tax–exempt status of the Bonds;
8. unscheduled draws on debt service reserves reflecting financial difficulties;
9. unscheduled draws on credit enhancements reflecting financial difficulties;
10. substitution of credit or liquidity providers, or their failure to perform; or
11. release, substitution or sale of property securing repayment of the Bonds.

The State Treasurer notes that items 8 and 11 are not applicable to the Bonds.

(b) The State Treasurer shall timely file a notice of the occurrence of a Listed Event, which is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository.

(c) The State reserves the right to make such notice of significant event filings through the Central Post Office.

SECTION 6. Termination of Reporting Obligation. The State’s obligations under Section 3, 4 and 5 of this Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the outstanding Bonds. If such termination occurs prior to the final

maturity of the Bonds, the State Treasurer shall give notice of such termination in the same manner as for a Listed Event under Section 5(b).

SECTION 7. Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the State Treasurer pursuant to this Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

SECTION 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the State Treasurer may amend or waive any provision of this Disclosure Certificate, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Section 3(a), 4, 5(a), or 8, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of 60% of the Bonds outstanding or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds. The State also may amend this Disclosure Certificate without approval by the Holders to the extent permitted by rule, order or other official pronouncement of the SEC.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the State Treasurer shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the State. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(b), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

SECTION 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the State Treasurer shall not have any obligation under this Disclosure Certificate to update such information or include it in any Annual Report or future notice of occurrence of a Listed Event.

SECTION 10. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity (except the right of the Dissemination Agent or any Holder or Beneficial Owner to enforce the provisions of this Disclosure Certificate on behalf of the Holders). This Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule.

SECTION 11. Partial Invalidity. If any one or more of the agreements or covenants or portions thereof required hereby to be performed by or on the part of the State Treasurer shall be contrary to law, then such agreement or agreements, such covenant or covenants or such portions thereof shall be null and void and shall be deemed separable from the remaining agreements and covenants or portions thereof and shall in no way affect the validity hereof, and the Holders of the Bonds shall retain all the benefits afforded to them hereunder. The State Treasurer hereby declares that he would have executed and delivered this Disclosure Certificate and each and every other article, section, paragraph, subdivision, sentence, clause and phrase hereof irrespective of the fact that any one or more articles, sections, paragraphs, subdivisions, sentences, clauses or phrases hereof or the application thereof to any person or circumstance may be held to be unconstitutional, unenforceable or invalid.

SECTION 12. Governing Law. The laws of the State of California shall govern this Disclosure Certificate, the interpretation thereof and any right or liability arising hereunder. Any action or proceeding to enforce or interpret any provision of this Disclosure Certificate shall be brought, commenced or prosecuted in Sacramento County, California.

IN WITNESS WHEREOF, the State Treasurer has executed this Disclosure Certificate as of the date first above written.

By \_\_\_\_\_  
A Deputy State Treasurer  
For State Treasurer, Philip Angelides

## **APPENDIX D**

### **PROPOSED FORMS OF LEGAL OPINIONS**

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## **FORM OF FINAL OPINION OF EACH CO-BOND COUNSEL**

[Closing Date]

**\$800,000,000**  
**State of California**  
**Various Purpose General Obligation Bonds**

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**(Final Opinion)**

We have acted as Co-Bond counsel to the State of California (the “State”) in connection with the issuance by the State of \$800,000,000 aggregate principal amount of State of California Various Purpose General Obligation Bonds, issued as seventeen separate series under fifteen bond acts, dated September 1, 2006, identified in Schedule A hereto (collectively, the “Bonds”). The Bonds are authorized pursuant to the respective bond acts identified in Schedule A (collectively, the “Laws”) and are issued pursuant to Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the “Resolutions”) adopted by the respective finance committees created under the Laws.

In such connection, we have examined the Resolutions, the tax certificate of the State (the “Tax Certificate”), other certifications of the State, and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all documents and the signatures thereto.

Certain agreements, requirements and procedures contained or referred to in the Resolutions, the Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, the defeasance of the Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in the documents. No opinion is expressed herein as to any Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions and the Tax Certificate, including (without limitation) agreements and covenants compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes.

We call attention to the fact that the rights and obligations under the Bonds, the Resolutions and the Tax Certificate may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors’ rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations on legal remedies against the State. Finally, we undertake no responsibility for the accuracy, completeness

or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The State has lawful authority for the issuance of the Bonds, and the Bonds constitute valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State are pledged to the punctual payment of the principal of and interest on the Bonds as the principal and interest become due and payable.

2. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the Bonds is not a specific preference item for purposes of calculating the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings in calculating corporate alternative minimum taxable income. We express no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Very truly yours,



## **Schedule A**

\$7,000,000 principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bonds, Series U, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Act of 2000 (The Villaraigosa-Keeley Act).

\$7,000,000 principal amount of State of California Safe, Clean, Reliable Water Supply Bonds, Series Y, authorized by the Safe, Clean, Reliable Water Supply Finance Committee under the Safe, Clean, Reliable Water Supply Act.

\$20,930,000 principal amount of State of California Class Size Reduction Kindergarten-University Public Education Facilities Bonds, Series BQ, authorized by the Higher Education Facilities Finance Committee under the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998.

\$310,000 principal amount of State of California Seismic Retrofit Bonds, Series AG, authorized by the Seismic Retrofit Finance Committee under the Seismic Retrofit Bond Act of 1996.

\$2,500,000 principal amount of State of California Clean Air and Transportation Improvement Bonds, Series AV, authorized by the Transportation Improvement Finance Committee under the Clean Air and Transportation Improvement Act of 1990.

\$1,000,000 principal amount of State of California School Facilities Bonds, Series AK, authorized by the State School Building Finance Committee under the Schools Facilities Bond Act of 1992.

\$670,000 principal amount of State of California Water Conservation Bonds, Series T, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

\$15,000 principal amount of State of California Safe Drinking Water Bonds, Series S, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

\$32,500,000 principal amount of State of California Reading and Literacy Improvement and Public Library Construction and Renovation Bonds, Series G, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

\$10,500,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series Y, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

\$5,000,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series Z, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

\$146,500,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series Z, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

\$102,500,000 principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Bonds, Series K, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

\$25,000,000 principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Bonds, Series J, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

\$103,500,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series M, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

\$326,575,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series L, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

\$8,500,000 principal amount of State of California Children's Hospital Bonds, Series B, authorized by the Children's Hospital Bond Act Finance Committee under the Children's Hospital Bond Act of 2004.

## FORM OF OPINION OF THE ATTORNEY GENERAL

[Closing Date]

The Honorable Philip Angelides  
State Treasurer  
Sacramento, California

\$800,000,000  
State of California  
Various Purpose General Obligation Bonds

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### Final Opinion

Honorable Philip Angelides:

We have acted as counsel to the State of California (the "State") in connection with the issuance by the State of \$800,000,000 aggregate principal amount of State of California Various Purpose General Obligation Bonds, issued as seventeen separate series under fifteen bond acts, dated September 1, 2006, all identified in Schedule A hereto, which is incorporated by reference (collectively, the "Bonds"). The Bonds are authorized pursuant to the respective bond acts identified in Schedule A (collectively, the "Laws") and are issued pursuant to Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the "Resolutions") adopted by the respective finance committees created under the Laws.

In such connection, we have examined the record of proceedings submitted to us relative to the issuance of the Bonds, including the Resolutions, certifications of the State, and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all signatures thereto.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof.

We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions. We call attention to the fact that the rights and obligations under the Bonds and the Resolutions may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations contained in State law regarding legal remedies against the State. We express no opinion as to whether interest on the Bonds is excluded from gross income for federal income tax purposes or exempt from State of California personal income taxes or as to any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated September 7, 2006 or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that the State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State of California are pledged to the punctual payment of the principal of and interest on the Bonds, as the principal and interest become due and payable.

Sincerely,

---

Deputy Attorney General

For BILL LOCKYER  
Attorney General

## **Schedule A**

\$7,000,000 principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bonds, Series U, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Act of 2000 (The Villaraigosa-Keeley Act).

\$7,000,000 principal amount of State of California Safe, Clean, Reliable Water Supply Bonds, Series Y, authorized by the Safe, Clean, Reliable Water Supply Finance Committee under the Safe, Clean, Reliable Water Supply Act.

\$20,930,000 principal amount of State of California Class Size Reduction Kindergarten-University Public Education Facilities Bonds, Series BQ, authorized by the Higher Education Facilities Finance Committee under the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998.

\$310,000 principal amount of State of California Seismic Retrofit Bonds, Series AG, authorized by the Seismic Retrofit Finance Committee under the Seismic Retrofit Bond Act of 1996.

\$2,500,000 principal amount of State of California Clean Air and Transportation Improvement Bonds, Series AV, authorized by the Transportation Improvement Finance Committee under the Clean Air and Transportation Improvement Act of 1990.

\$1,000,000 principal amount of State of California School Facilities Bonds, Series AK, authorized by the State School Building Finance Committee under the Schools Facilities Bond Act of 1992.

\$670,000 principal amount of State of California Water Conservation Bonds, Series T, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

\$15,000 principal amount of State of California Safe Drinking Water Bonds, Series S, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

\$32,500,000 principal amount of State of California Reading and Literacy Improvement and Public Library Construction and Renovation Bonds, Series G, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

\$10,500,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series Y, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

\$5,000,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series Z, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

\$146,500,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series Z, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

\$102,500,000 principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Bonds, Series K, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

\$25,000,000 principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Bonds, Series J, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

\$103,500,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series M, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

\$326,575,000 principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series L, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

\$8,500,000 principal amount of State of California Children's Hospital Bonds, Series B, authorized by the Children's Hospital Bond Act Finance Committee under the Children's Hospital Bond Act of 2004.

**APPENDIX E**  
**SPECIMEN MBIA POLICY**

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# FINANCIAL GUARANTY INSURANCE POLICY

## MBIA Insurance Corporation Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless the Insurer elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of a such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

[PAR]  
[LEGAL NAME OF ISSUE]

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

In the event the Insurer were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

MBIA Insurance Corporation

\_\_\_\_\_  
President

Attest:

\_\_\_\_\_  
Assistant Secretary

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**APPENDIX F**  
**SPECIMEN FSA POLICY**

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**FINANCIAL  
SECURITY  
ASSURANCE®**

## **MUNICIPAL BOND INSURANCE POLICY**

ISSUER:

Policy No.: -N

BONDS:

Effective Date:

Premium: \$

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment

made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By \_\_\_\_\_

By \_\_\_\_\_  
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.  
31 West 52<sup>nd</sup> Street, New York, N.Y. 10019

(212) 826-0100

Form 500NY (5/90)

**APPENDIX G**  
**SPECIMEN AMBAC POLICY**

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## Financial Guaranty Insurance Policy

Ambac Assurance Corporation  
One State Street Plaza, 15th Floor  
New York, New York 10004  
Telephone: (212) 668-0340

Obligor:

Policy Number:

Obligations:

Premium:

Ambac Assurance Corporation (Ambac), a Wisconsin stock insurance corporation, in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to The Bank of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of the Holders, that portion of the principal of and interest on the above-described obligations (the "Obligations") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor.

Ambac will make such payments to the Insurance Trustee within one (1) business day following written notification to Ambac of Nonpayment. Upon a Holder's presentation and surrender to the Insurance Trustee of such unpaid Obligations or related coupons, uncanceled and in bearer form and free of any adverse claim, the Insurance Trustee will disburse to the Holder the amount of principal and interest which is then Due for Payment but is unpaid. Upon such disbursement, Ambac shall become the owner of the surrendered Obligations and/or coupons and shall be fully subrogated to all of the Holder's rights to payment thereon.

In cases where the Obligations are issued in registered form, the Insurance Trustee shall disburse principal to a Holder only upon presentation and surrender to the Insurance Trustee of the unpaid Obligation, uncanceled and free of any adverse claim, together with an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee duly executed by the Holder or such Holder's duly authorized representative, so as to permit ownership of such Obligation to be registered in the name of Ambac or its nominee. The Insurance Trustee shall disburse interest to a Holder of a registered Obligation only upon presentation to the Insurance Trustee of proof that the claimant is the person entitled to the payment of interest on the Obligation and delivery to the Insurance Trustee of an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee, duly executed by the Holder or such Holder's duly authorized representative, transferring to Ambac all rights under such Obligation to receive the interest in respect of which the insurance disbursement was made. Ambac shall be subrogated to all of the Holders' rights to payment on registered Obligations to the extent of any insurance disbursements so made.

In the event that a trustee or paying agent for the Obligations has notice that any payment of principal of or interest on an Obligation which has become Due for Payment and which is made to a Holder by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from the Holder pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such Holder will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

As used herein, the term "Holder" means any person other than (i) the Obligor or (ii) any person whose obligations constitute the underlying security or source of payment for the Obligations who, at the time of Nonpayment, is the owner of an Obligation or of a coupon relating to an Obligation. As used herein, "Due for Payment", when referring to the principal of Obligations, is when the scheduled maturity date or mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Obligations, is when the scheduled date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Obligor to have provided sufficient funds to the trustee or paying agent for payment in full of all principal of and interest on the Obligations which are Due for Payment.

This Policy is noncancelable. The premium on this Policy is not refundable for any reason, including payment of the Obligations prior to maturity. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Obligation, other than at the sole option of Ambac, nor against any risk other than Nonpayment.

In witness whereof, Ambac has caused this Policy to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

President



Secretary

Effective Date:

Authorized Representative

THE BANK OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Form No.: 2B-0012 (1/01)

G-1

Authorized Officer of Insurance Trustee

## Endorsement

Policy for:

Attached to and forming part of Policy No.:

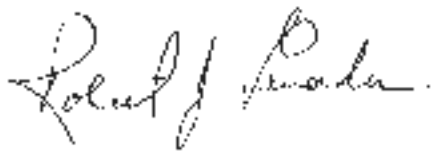
Effective Date of Endorsement:

In the event that Ambac Assurance Corporation were to become insolvent, any claims arising under the Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Policy other than as above stated.

**In Witness Whereof,** Ambac has caused this Endorsement to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

### Ambac Assurance Corporation



President



Secretary

Authorized Representative



